APPENDIX A

COURT OF APPEALS OF NEW MEXICO

No. 13,035

NCR CORPORATION,
Protestant-Appellant,

v.

TAXATION AND REVENUE DEPARTMENT OF THE STATE OF NEW MEXICO,
Respondent-Appellee.

May 6, 1993

DONNELLY, Judge

OPINION

NCR Corporation (NCR) appeals from an administrative decision and order of the State Taxation and Revenue Department (Department), denying NCR's challenge to four separate deficiency assessments of corporate income tax, penalty, and interest. It contends that (1) the Foreign Commerce Clause, Article I, Section 8, Clause 3 of the United States constitution prohibits New Mexico from imposing a corporate income tax upon NCR's foreign source royalty, interest, and dividend income; (2) the Due Process Clause, Amendment XIV of the United States Constitution prohibits New Mexico from taxing an apportioned share of NCR's Subpart F income; and (3) the Due Process Clauses of the state [1] and federal constitu-

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[1] N.M. Const. art. II, § 18 (Repl. Pamp. 1992).

tions require that New Mexico modify its apportionment formula as it relates to NCR. We affirm the decision and order of the administrative hearing officer entered below; we remand, however, for determination of the amount of credits due for taxes previously paid by NCR.

FACTS

The Department issued corporate income tax assessments against NCR for taxes due in 1981 through 1987, totalling approximately $439,681.80, plus interest and penalties. The assessments principally relate to income earned outside the United States by NCR and its foreign subsidiaries. NCR protested each of the assessments and its challenges were consolidated for hearing before a hearing officer on August 29, 1990.

The parties stipulated, inter alia, that NCR was incorporated in Maryland and maintains its corporate headquarters and principal place of business in Ohio. NCR is engaged in the manufacture of business equipment, computers, and machinery, and sells its products, supplies, and services at wholesale and retail world-wide. It conducts its businesses in foreign countries either directly or through its foreign subsidiaries and branches, through the ownership of stock in foreign subsidiaries, through ownership of patents and license agreements with foreign subsidiaries, and through loan agreements. NCR does not contest New Mexico's taxation of its branch income. The operation of NCR's foreign subsidiaries and its foreign branches is nearly identical. All significant operating decisions for both branches and subsidiaries are made at NCR's corporate headquarters in the United States. The royalties, interest, and dividends received by NCR from its foreign subsidiaries were treated as gross income of NCR. Either NCR or its foreign subsidiaries was subject to tax on the income earned in the host country.

During the years in question, NCR had seventeen manufacturing facilities throughout the world; each was operated either directly by NCR or through a subsidiary. During this same time period, NCR conducted business in all fifty states, including New Mexico. NCR had ten domestic subsidiaries, approximately seventy-five foreign subsidiaries, and eighteen foreign branches. Approximately 70% of all products sold by NCR are manufactured in the United States and shipped overseas. NCR does business essentially through its domestic and foreign subsidiaries operating together as a fully-integrated unitary business and, except for its Japanese subsidiary, NCR owns 100% of the stock of its other foreign subsidiaries.

The income tax assessed by the Department against NCR during the applicable time periods was based upon an apportionment formula utilized by the state and which apportioned a share of NCR's total income as reported to the federal government. To calculate the amount of tax due, the Department took NCR's reported federal taxable income, deducted foreign dividend gross-up, income from United States obligations, and non-business income allocated to other states, and then apportioned NCR's New Mexico income in accordance with the statutory formula specified by the Uniform Division of Income for Tax Purposes Act (UDITPA). NMSA 1978, §§ 7-4-1 to -21 (Repl. Pamp. 1990). The Department then imposed an apportioned income tax by taxing NCR's unitary business income.[2]

The tax imposed by the Department, subject to certain deductions, is levied on a percentage basis determined by comparing NCR's New Mexico business income to the remainder of its business. This formula resulted in a tax apportionment factor, which varied depending on

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[2] New Mexico utilizes a hybrid system of corporate income tax reporting. *See Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 168 (1983).

the applicable year, of between 0.3307% and 0.2207% of NCR's annual federal taxable income.

Following the administrative hearing, the hearing officer disallowed NCR's protest of each of the tax assessments imposed by the Department, except insofar as NCR protested the inclusion of a portion of its Subpart F income which was previously taxed in New Mexico, and except for allowance of a deduction for previous tax payments made by NCR for the tax years in question.

I. *Foreign Commerce Clause*

NCR contends that the Foreign Commerce Clause of the United States Constitution bars imposition of New Mexico's corporate income tax upon a proportionate share of NCR's corporate income received in the form of royalties, interest, and dividends from its foreign subsidiaries, and which is earned in, and subject to taxation by, foreign countries. In advancing this argument, NCR argues that allocation of NCR's corporate income to a single situs and apportionment is constitutionally prohibited under the Foreign Commerce Clause, and that New Mexico's apportionment formula results in impermissible multiple international taxation and contravenes national policy.

NCR asserts that New Mexico's statutory apportionment formula is prohibited under the Foreign Commerce Clause because Section 7-4-10 must be read to require inclusion of its entire property, payroll, and sales of its dividend, royalty, and interest-paying foreign subsidaries in calculating the denominator of the apportionment factor applied to the taxable portion of its foreign income. Thus, it contends the tax in question is a tax on its foreign subsidiaries. We do not believe the statute or its application in the instant case offends the Foreign Commerce Clause. Reading Sections 7-4-10, -11, -14, and -16 together, and in light of the provisions of UDITPA, we think, evinces a clear legislative intent to impose the

tax on the property, payroll, and sales of the unitary business of the "taxpayer." In this case the "taxpayer" is NCR, not its foreign subsidiaries. *See Giant Indus. Ariz., Inc. v. Taxation & Revenue Dep't,* 110 N.M. 442, 445, 796 P.2d 1138, 1141 (Ct. App. 1990) (fundamental purpose of statutory interpretation is to further legislative intent and purpose).

New Mexico utilizes a three-factor apportionment formula as set forth in UDITPA. A majority of states, including New Mexico, have adopted UDITPA, or a variation of such uniform legislation. *Barclays Bank Int'l. Ltd. v. Franchise Tax Bd.,* 829 P.2d 279, 282 (Cal. 1992) (en banc); *see also* 1 *State Tax Guide* ¶ 10-110, at 1061-63 (Commerce Clearing House, 2d ed.1991); 4 Zolman Cavitch, *Business Organizations* § 7904, at 7929 (1992); *see generally* Larry D. Scheafer, Annotation, *Construction and Application of Uniform Division of Income for Tax Purposes Act,* 8 A.L.R.4th 934 (1981); Uniform Division of Income for Tax Purposes Act, 7A U.L.A. 331 (1985).

As specified in UDITPA, Section 7-4-10, "All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three." Under this statutory formula, the income attributable to the state is determined by multiplying the taxpayer's gross income by a fraction which represents the ratio of sales, payroll, and property located in the state to the total sales, payroll, and property of the corporation.

Relying in part upon the decision in *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979), NCR also asserts that the Foreign Commerce Clause precludes the state, even on an apportioned basis, from imposing any tax upon the royalty, interest, and dividend income earned by it from its foreign subsidiaries, because this income has already been taxed on an unapportioned basis

by the government of the foreign country in which the income was generated and earned. NCR argues that in Japan Line, which involved a challenge of local taxation of foreign, rather than interstate commerce, the Court held that the Foreign Commerce Clause imposed greater restraints upon state taxing authority than those articulated in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977), relating to restrictions emanating from the Interstate Commerce Clause. It argues that the hearing officer erred in failing to determine, under the rationale of *Japan Line,* that the taxes assessed fail to satisfy constitutional scrutiny. We reach a different conclusion from that asserted by NCR and find that the tax imposed here survives the six-part test set forth in *Japan Line.*

In *Complete Auto Transit,* the United States Supreme Court observed that where purely *interstate* commerce is involved, a state tax will survive Commerce Clause scrutiny when "the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id.,* 430 U.S. at 279.

In *Japan Line* the Court applied a six-part test, holding that where a taxing authority seeks to tax foreign commerce it must satisfy the four-part inquiry set forth in Complete Auto Transit to determine the validity of state or local taxation of interstate commerce and, in addition, must satisfy two additional considerations:

> [F]irst, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the Federal Government from "speaking with one voice when regulating commercial relations with foreign governments." If a state tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause.

Japan Line, 441 U.S. at 451.

Pointing to the decisions in *Japan Line* and *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), NCR contends that New Mexico, in seeking to tax the income of a multistate or multinational business, is limited under the Commerce Clause and Foreign Commerce Clause to taxing only the income of such an entity earned within the state. We do not read the authorities relied upon by NCR so restrictively. While it is true that in *ASARCO, Inc.* and *Container Corp.*, the Supreme Court held that under both the Due Process Clause and the Commerce Clause a state may not impose an income tax upon value earned by a taxpayer beyond the state's borders, the Court, in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439-40 (1980), recognized that a state may lawfully impose a fairly apportioned income tax upon such taxpayer. The general premise underlying unitary taxation is that the value of a corporation's unitary business is apportionable to a state for taxation if the corporation's operations within the state contribute to the profitability of the entity's overall business. *Id.*

Similarly, the Court in *Container Corp.* observed that multiple taxation of a multinational, world-wide unitary enterprise may, when properly apportioned, survive the restrictions articulated in *Japan Line*. Although the *Japan Line* Court held that a state tax on foreign instrumentalities of commerce may neither impose multiple tax burdens on international commerce nor impair federal uniformity in an area where federal uniformity is essential, in a subsequent decision, *Container Corp.*, the Court declined to declare invalid California's apportioned corporate income tax. *Container Corp.* held that while "[a]llocating income among various taxing jurisdictions bears some resemblance . . . to slicing a shadow," *id.*, 463 U.S. at 192, nevertheless, it was unwilling to require a state to give up one method of allocation that may at times result in double taxation in favor of another allocation method that may also result in double taxation. *Id.* at 193-96. Thus, the *Container Corp.* Court declined to infer that the state's use of unitary taxation

violated a clear federal policy requiring uniform state income taxation of foreign commerce. The United States Constitution does not impose any single method of apportionment on a multistate or multinational taxpayer's income. *See Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 445 (1940).

The Department disputes NCR's claims that the Supreme Court's decision in *Japan Line* is dispositive of the issue of constitutionality raised here. The Department asserts that the court's decision in *Japan Line* is inapplicable to the facts of the instant case because *Japan Line* involved a challenge to the taxing authority's imposition of an ad valorem property tax on cargo containers owned by Japanese companies engaged in foreign commerce and which were transported to California ports en route to other places. We agree. Unlike the situation in *Japan Line*, which involved six Japanese shipping companies engaged in the transport of cargo in foreign commerce. and an ad valorem property tax, which was determined to constitute an unlawful restraint on foreign commerce, the present case presents a different factual basis. Here, NCR is domiciled in the United States, engages in business in New Mexico, and the tax in question is an apportioned corporate income tax on NCR's unitary business income.

In contrast to the tax involved here, the tax imposed in *Japan Line* was a tax on a foreign entity, not a domestic corporation. In *Japan Line* several municipalities in California levied ad valorem personal property taxes on cargo containers used by the shipping companies. The cargo containers were taxed at full value in Japan. Moreover. unlike the situation in *Japan Line*, the Court in *Container Corp.* unheld the tax in question, noting that the California net income tax was imposed on the domestic parent of foreign subsidiaries and not upon a foreign entity. *Container Corp.*, 463 U.S. at 195.

Does the New Mexico corporate income tax apportionment scheme, as applied in this case, pass constitu-

tional muster against contentions that such tax fails to survive Commerce Clause scrutiny and violates the Foreign Commerce Clause? We conclude that it does and that the basic premise and holding of the Court in *Container Corp.* is controlling here.

The income the Department seeks to tax is derived from NCR's subsidiaries that operate together as a fully-integrated unitary business. *Cf. Kewanee Indus., Inc. v. Reese*, — N.M. —, — n.5. 845 P.2d 1238, 1242 n.5 (1993). The tax in question is not a tax on any of NCR's foreign subsidiaries; instead, the tax falls upon an apportioned share of NCR's income which it receives in the form of royalties, interest, and dividends from its unitary foreign subsidiaries. The fact that the tax is apportioned in part upon NCR's foreign income sources does not constitute a bar to state taxation. *See Mobil Oil Corp.*, 445 U.S. at 439-40.

NCR's argument that both the Commerce Clause and the Foreign Commerce Clause of the United States Constitution prohibit New Mexico from imposing its income tax on NCR's royalties, interest, and dividends which were subject to the taxing jurisdiction of foreign countries, has been considered and rejected in several other jurisdictions. *See NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn.), *cert. denied*, 493 U.S. 848 (1989); *NCR Corp. v. South Carolina Tax Comm'n*, 402 S.E.2d 666 (S.C.1991); *see also NCR Corp. v. Comptroller of the Treasury, Income Tax Div.*, 544 A.2d 764 (Md.1988). We find these decisions instructive in the instant case.

The Minnesota Supreme Court, in *Commissioner of Revenue*, considered a similar argument by NCR and concluded that the Minnesota unitary business income tax apportionment formula did not violate the Due Process or Foreign Commerce Clauses of the United States Constitution, or result in impermissible multiple taxation.

In *South Carolina Tax Commission* the South Carolina Supreme Court turned aside a similar argument to that raised by NCR in the instant case. In that case, as here, NCR placed great reliance on the Supreme Court's decision in Japan Line. The South Carolina court found unpersuasive NCR's claim that the Foreign Commerce Clause precluded the tax commission's inclusion in NCR's total taxable income the royalty and interest income it received from its foreign subsidiaries. In rejecting this argument, the court held:

> [T]he case controlling the situation here is not *Japan Line* in our view, but *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 . . . (1983). In *Container Corp.* the Court retreated from its broad *Japan Line* rules and in our view restricted *Japan Line* substantially. *Container Corp.* again involved a California tax. This time, however, the tax was an apportioned corporate income tax on Container Corporation, a company headquartered in Illinois but doing business in California as well as other states and countries. California imposed the same three-factor apportionment formula upon Container [C]orporation as was here imposed by the Tax Commission on NCR.

South Carolina Tax Comm'n, 402 S.E.2d at 670.

We arrive at a similar result to that reached by the court in *South Carolina Tax Commission* and the Minnesota Supreme Court in *Commissioner of Revenue*, each of which denied related challenges of NCR to the imposition of an apportioned state income tax.

In rejecting the arguments advanced above, we have also considered NCR's contention that New Mexico's tax impairs federal uniformity in an area where uniformity is essential and that the imposition of such tax may impede federal policy. We do not agree that the limitations cited by NCR bar the imposition of the tax here in issue. In *Japan Line* the Court held that to withstand scrutiny under the Foreign Commerce Clause a state tax must meet the standards with respect to state taxation

of interstate commerce enunciated in *Complete Auto Transit* and, additionally, the tax must not give rise to the risk of multiple taxation or prevent the federal government from speaking with one voice when regulating commercial relations with foreign countries. *Japan Line*, 441 U.S. at 453; see also *Colgate-Palmolive Co. v. Franchise Tax Bd.*, 13 Cal.Rptr.2d 761, 767 (Ct.App.1992) (unitary state tax held to survive constitutional challenge alleging violation of Foreign Commerce Clause, where tax meets requirements of Interstate Commerce Clause test and tax is not shown to create substantive risk of international taxation and does not impair need for federal uniformity where federal uniformity is essential).

Applying this test to the facts before us, we conclude that NCR's challenges here must fail.[3] Contrary to the contentions of NCR, in the instant case, New Mexico is taxing only an apportioned share of the income of NCR, a domestic corporation, not imposing a tax on tangible property of a foreign corporation. Unlike the situation in *Japan Line*, multiple taxation, although real, is not inevitable, the tax was fairly apportioned under the formula set forth in UDITPA, and the legal incidence of the tax here does not fall on a foreign owner but instead is upon a unitary, domestic entity. Moreover, NCR has failed to establish that the tax here violates the "one voice" standard or implicates foreign policy issues which must be left to the United States government. *Cf. Intel Containers Int'l Corp. v. Huddleston*, — U.S. —, —, 113 S. Ct. 1095, 1103, 122 L. Ed. 2d 421, 435 (1993) (Tennessee's sales tax as applied to cargo containers leased by corporation for use in international shipping found not to violate the Foreign Commerce Clause under *Japan Line*'s

[3] In *Container Corp.* the Court observed, "[I]f a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, '[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States.'" *Id.*, 463 U.S. at 194 (quoting *Mobil Oil Corp.*, 445 U.S. at 448).

three-part test, and tax did not create substantial risk of multiple taxation implicating foreign commerce concerns).

II. *Commerce Clause—NCR's Subpart F Income*

NCR argues, alternatively, that even if this Court affirms the hearing officer's determination that its foreign source royalties, interest, and dividends can be included in its New Mexico apportionable tax base without impinging upon the limitations of the Foreign Commerce Clause, nevertheless, under the Due Process Clause, the state is precluded from including in its apportionable tax base the Subpart F portion of NCR's foreign source dividends.

NCR argues that its Subpart F income is exempt from taxation by the Department because income may not be taxed until it is actually realized. Thus, it asserts that this principle precludes taxation of a shareholder on income earned by NCR until it is distributed.

The Commerce Clause states that "Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States and with the Indian Tribes." U.S. Const. art. I, § 8, cl. 3. The Commerce Clause has been recognized as a restriction upon the power of a state to regulate or tax interstate and foreign commerce even in the absence of the enactment of specific congressional legislation. *See Container Corp.*, 463 U.S. at 164; *Japan Line*, 441 U.S. at 444; *see generally* E.H. Schopler, Annotation, *Validity, Under Federal Constitution, of State Tax On, Or Measured by, Income of Foreign Corporation*, 67 A.L.R.2d 1322 (1959); Scheafer, *supra*. The Foreign Commerce Clause of the United States Constitution also imposes restrictions upon the taxing authority of the states. *See Japan Line*, 430 U.S. at 451.

NCR contends that its Subpart F income is not business income under Section 7-4-2(A) and is not appor-

tionable under Section 7-4-10. NCR bases its challenge to the inclusion of its Subpart F income on three principal grounds. First, it contends that Subpart F income is hypothetical income, similar to gross-up income which this state does not tax; hence, it contends, Subpart F income is not subject to taxation. Second, NCR argues that the Department is barred from taxing Subpart F income under the Due Process Clause of the United States Constitution. Third, it argues that a portion of its Subpart F income has been previously taxed and New Mexico is precluded by the Equal Protection Clause, the Commerce Clause, and the Due Process Clause of the New Mexico Constitution from taxing this income a second time. We disagree.

In *Estate of Whitlock v. Commissioner of Internal Revenue Service*, 59 T.C. 490 (1972), *aff'd*, 494 F.2d 1297 (10th Cir.1974), the court rejected the argument that Subpart F income is hypothetical. Subpart F of the Internal Revenue Code (IRC), 26 U.S.C. §§ 951-964 (1982), contains a limited exception to the general rule that shareholders are not subject to taxation on the undistributed earnings of their corporations. IRC Section 951(a)(1) provides that United States shareholders of "controlled foreign corporation[s]" are required to report as income their pro rata share of such corporation's undistributed income, consisting of the controlled foreign corporation's "Subpart F income" and its increase in earnings invested in United States property. The effect of such legislation is to provide that the shareholders of controlled foreign corporations shall be treated as if they had received actual dividend distributions from such corporations even though no income has been actually distributed. IRC § 951(a)(2).

Under IRC Section 951(a)(2)(A), a shareholder of a controlled foreign corporation must include in its share of such corporation's Subpart F income that income "which would have been distributed with respect to the

stock which such shareholder owns . . . if . . . it had distributed [a pro rata share of] . . . its subpart F income," reduced by certain actual dividend distributions. Id. United States shareholders must also include in his or her pro rata share of the amount of earnings that a controlled foreign corporation invests in United States property for any taxable year "to the extent not excluded from gross income under [other provisions of the Internal Revenue Code]." IRC § 951(a)(1)(B).

NCR also argues that the Due Process Clause of the United States Constitution confines the state's power to tax nondomiciliary corporations engaged in interstate or foreign business to income or property that has its source within the state. *See, e.g., Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 272-73 (1978); *Norfolk & W. Ry. v. Missouri State Tax Comm'n,* 390 U.S. 317, 325 (1968). We do not find this argument persuasive under the facts existing here. As observed by the United States Supreme Court in *Mobil Oil Corp.,* 445 U.S. at 438:

> The argument that the source of the income precludes its taxability runs contrary to precedent. In the past, apportionability has often been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and extrastate activities formed part of a single unitary business.

In the instant case it is undisputed that there is a substantial flow of goods between NCR and its domestic and foreign subsidiaries and branches, and that NCR conducts its business world-wide through its domestic and foreign subsidiaries as a single, integrated unitary operation. Since NCR conducts part of its unitary business in this state, New Mexico has the right to impose a corporate income tax on an apportioned share of NCR's unitary income. *See F.W. Woolworth Co. v. Taxation & Revenue Dep't,* 458 U.S. 354 (1982) (state may tax

corporation income if it arises from subsidiaries whose business is part of the corporation's unitary business). We have examined each of the arguments and authorities relied upon by NCR, including its challenge on state constitutional grounds, and conclude that because its subsidiaries with Subpart F income remain part of its unitary business and the federal government requires inclusion of NCR's Subpart F income in the corporation's gross income, under the unitary business principle, the state assessments in question here do not violate the United States or New Mexico Constitutions, are fairly apportioned, and tax a fair portion of such income. *See Mobil Oil Corp.*, 445 U.S. at 438; *see also Container Corp.*, 463 U.S. at 165-67; *Comptroller*, 544 A.2d at 768-70; *see generally* William D. Dexter, *Attribution of a Multinational Corporation's Net Income: The Position of Unitary States Regarding Combined Reporting*, 18 Vand. J. Transnat'l L. (1985).

III. *Validity of Apportionment*

NCR's final argument raised on appeal asserts that even if this Court upholds the decision of the hearing officer against its first and second challenges, nevertheless, New Mexico's apportionment method must be modified so as to reflect certain factors which give rise to NCR's foreign source income. In advancing this contention, NCR asserts that New Mexico's apportionment statute, Section 7-4-10, necessitates inclusion of all or a portion of its foreign subsidiaries, expenses in computing NCR's proper formula percentage. NCR also contends that its disputed foreign source income (royalties, interest, and dividends) is neither taxable nor apportionable by New Mexico because (1) that income is earned by NCR in foreign countries where such income is subject to an unapportioned tax and that income is not attributable to New Mexico; and (2) NCR's Subpart F income may not be taxed by New Mexico and may not be subjected to apportionment by the state.

NCR urges this Court to follow the reasoning of Justice Stevens in his dissenting opinion in *Mobil Oil Corp.* which argues that "[u]nless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause [the corporation's] income to be overstated." *Id.*, 445 U.S. at 449, 461 (footnote omitted). In resolving this issue, however, we are guided by the rationale of the majority decision which rejected the views set forth in the dissent.

In challenging the efficacy of New Mexico's apportionment formula, as applied here, NCR further argues that the formula fails to satisfy the test of fairness set forth in *Container Corp.* In *Container Corp.* the Supreme Court emphasized that two standards must be met in order for an apportionment formula to be fair, e.g., "internal consistency," and "external consistency." *Id.*, 463 U.S. at 169. The test of internal consistency is that the formula must be such that if it were applied by every jurisdiction, it would result in a tax which does not exceed the unitary business's income. The requirement that the apportionment formula satisfy external consistency mandates that the factors used in the apportionment scheme "actually reflect a reasonable sense of how income is generated." *Id.*

As noted in *Container Corp.*, a taxpayer seeking to invalidate a state's apportionment formula must show by clear and cogent evidence that the income attributed to the state is in fact disproportionate to the business transacted in that state. *Id.*, 463 U.S. at 179, 180-81. In *South Carolina Tax Commission* the South Carolina Supreme Court, guided, in part, by the Supreme Court's decision in *Container Corp.*, rejected a like contention by NCR that South Carolina's statutory apportionment scheme impermissibly required NCR's foreign subsidiaries, payroll, property, and sales to be included in the denomi-

nator of that state's apportionment formula. Similarly, in *Comptroller*, 544 A.2d at 768, the Maryland Court of Appeals noted:

> "Under both the Due Process and Commerce Clauses of the [United States] Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.'" *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 164 . . . (quoting *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 . . . (1982)). Nonetheless, "[i]t has long been established that the income of a business operating in interstate commerce is not immune from fairly apportioned state taxation." *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 423, 436 . . . (1980). . . .
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> In order to challenge successfully State apportionment of corporate income, "the taxpayer [must] . . . prove 'by clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State . . . . or has led to a grossly distorted result. . . .'" *Container Corp., supra*, 463 U.S. at 170 . . . (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 . . . (1978)).

Has NCR established that New Mexico's apportioned income tax upon a share of its unitary income for the years in question results in a grossly distorted result? We hold that it has not. *See id.*; *see also Tipperary Corp. v. New Mexico Bureau of Revenue*, 93 N.M. 22, 24, 595 P.2d 1212, 1214 (Ct.App.) (taxpayer has duty to present evidence overcoming correctness of assessment), *cert. denied*, 92 N.M. 675, 593 P.2d 1078 (1979); *cf. Crocker Equip. Leasing, Inc. v. Department of Revenue*, 838 P.2d 552, 557 (Or.1992) (en banc) (taxpayer has burden of proving that statutory apportionment formula does not fairly represent taxpayer's business activity). NCR has failed to establish that the method of apportionment

utilized by the Department is contrary to law or unfairly applied for the time periods in question. Similarly, we conclude that New Mexico's apportionment statute, Section 7-4-10, and the assessments challenged herein meet the test of fairness specified in *Container Corp.*, and do not violate the Due Process and Commerce Clauses of the United States Constitution or the Due Process Clause of the New Mexico Constitution. N.M. Const. art. II, § 18 (Repl. Pamp.1992). Based upon the record before us, however, we note that the hearing officer found that NCR is entitled to credits for income taxes previously paid by it for certain of the years in question. Since a portion of NCR's Subpart F income was previously taxed for the tax years 1978 through 1980, we agree that NCR is entitled to an adjustment of the tax assessment. Neither NCR nor the Department has contested this portion of the hearing officer's ruling.

CONCLUSION

We affirm the decision and order entered below. We remand, however, for determination by the hearing officer of the amount of the allowable adjustment from the additional taxes imposed, because of NCR's previous payment of taxes for certain of the years in question.

IT IS SO ORDERED.

/s/ Thomas A. Donnelly
THOMAS A. DONNELLY
Judge

WE CONCUR:

/s/ A. Joseph Alarid
A. JOSEPH ALARID
Judge

/s/ Benjamin Anthony Chavez
BENJAMIN ANTHONY CHAVEZ
Judge

APPENDIX B

BEFORE THE HEARING OFFICER OF
THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO

IN THE MATTER OF NCR CORPORATION,
I.D. No. 01-009509-00 6, Protest to
Assessment No. 5909, 5929, 5932 and 7846

DECISION AND ORDER

This matter came on for hearing on August 29, 1991 before Gerald B. Richardson, Hearing Officer. NCR Corporation was represented by its local counsel, Curtis W. Schwartz, Esq., and by Paul H. Frankel, Esq. of Morrison and Foerster of New York, at the hearing. Leave was granted for Walter Hellerstein, Esq., also of Morrison and Foerster, to join Messrs. Schwartz and Frankel on behalf of NCR Corporation in the briefing process. The Taxation and Revenue Department, hereinafter the Department, was represented by Daniel Yohalem, Esq. At the hearing, the parties presented an extensive stipulation of facts, which left a few numerical details to be worked out after the parties reviewed additional information which had recently been exchanged. A finalized version of the stipulated facts was submitted to the hearing officer on November 2, 1990, during the briefing process. The parties are to be commended for their hard work and cooperation in arriving at the extensive stipulation of facts which was submitted. The result is that all relevant facts have been stipulated to by the parties, leaving the hearing officer only the difficult task of resolving the legal issues presented by this matter. The stipulated facts are

hereby adopted in their totality as this hearing officer's findings of fact and are set forth fully below.

At the close of the hearing, the parties agreed that they would submit their arguments in the form of written briefs. The briefing process was completed with the submission on January 15, 1991 of NCR Corporation's reply brief. Due to the complexity of this matter, the parties agreed to a somewhat extended briefing process to allow for full exposition of the issues. The parties also agreed to grant the hearing officer an additional 30 days beyond the 30-day time limit found at Section 7-1-24(H) NMSA 1978 to render his decision in this matter. Both parties are to be complimented on the excellent briefs which were submitted. Based upon the evidence and the arguments submitted in this matter, IT IS DECIDED AND ORDERED that:

FINDINGS OF FACT

1. NCR Corporation is incorporated in the state of Maryland and has its corporate headquarters and principal place of business in the state of Ohio. NCR Corporation is engaged in the manufacturing and sale of business equipment and machines, including point-of-sale terminals (computerized cash registers), automatic bank teller machines, mainframe computers and personal computers.

2. During the periods in question, NCR Corporation had 17 manufacturing facilities throughout the world, each of which it operated directly or through a subsidiary. Twelve of these facilities are located in the United States, and one each is located in Japan, Canada, Scotland, Germany and Mexico. Approximately 70% of all products sold by petitioner are manufactured in the United States and shipped overseas.

3. During each year in question, NCR Corporation transacted business through the selling of its products and related supplies and services at wholesale and retail levels partly within and partly outside the state of New Mexico. The property, payroll and sales of: a) NCR Corporation

in New Mexico; b) NCR Corporation within the United States; and c) NCR's relevant foreign subsidiaries are found in paragraphs 34, 35 and 37, respectively, below.

4. During the relevant periods, NCR Corporation conducted business in all fifty states. NCR Corporation wholly owns approximately ten active domestic subsidiaries. The domestic subsidiaries engaged in a wide range of activities, including but not limited to the following:

NCR Comten	Computer Networking Systems
Applied Digital Data Systems	TTY CTR Manufacturing
NCR International	Holding Company of Approximately 50% of Foreign Subsidiary Stock
NCR Credit Corp.	Financing Purchases by NCR Customers
NCC Leasing, Inc.	Leasing Equipment
NCR Egypt, Inc.	Operates Egypt Branch
Overseas Trading Corp.	Software Distributor in Brussels, Belgium
ATM Services, Inc.	Servicing of ATM's
Information Imaging	Computer Generated Printed & Microfilm Output
NACAR	Rental Property

5. Each year in question NCR Corporation filed returns with and paid taxes to the state of New Mexico on a federal consolidated basis in conformance with Section 7-2A-8.4 NMSA 1978. NCR Corporation included in each of these consolidated returns all its domestic subsidiaries, including but not limited to the subsidiaries described in paragraph 4, above. All the companies included in the consolidated group operate together as a fully-integrated unitary business and in all respects are unitary with the business any of them transact in New Mexico.

6. NCR Corporation conducts its business in foreign countries directly and through its foreign subsidiaries and branches, through the ownership of stock in foreign subsidiaries, through exploitation of patents and license agree-

ments with foreign subsidiaries and through loan agreements. NCR Corporation has approximately 75 foreign subsidiaries and 18 foreign branches which conduct business in approximately 150 countries worldwide. NCR Corporation's foreign subsidiaries and branches are, primarily, engaged in marketing and operate for the purpose of selling, marketing and distributing the products manufactured by NCR Corporation. Except as to its Japanese subsidiary (in which NCR Corporation owns approximately 70% of the outstanding stock) and certain other smaller subsidiaries, NCR Corporation owns 100% of the stock of its foreign subsidiaries.

7. The operation of NCR Corporation's foreign subsidiaries and its foreign branches is nearly identical. The foreign subsidiaries use the same accounting policies as the foreign branches and the rest of the Corporation. The only difference between the foreign subsidiaries and the foreign branches is that the subsidiaries are separate corporations while the branches are divisions of NCR Corporation. All significant operating decisions for both the branches and subsidiaries are made at the Corporate Headquarters located in Dayton, Ohio. The decision to conduct business in a foreign country through a subsidiary corporation rather than a branch office is not always within the exclusive control of NCR Corporation, but may be dictated by the laws and policies of that foreign country.

8. From a management perspective, the different organizational and geographic forms in which business is conducted make very little practical difference, whether domestically or internationally or whether through a division, branch or subsidiary corporation. NCR Corporation operates them all through a centralized accounting system, a centralized cash management system and a centralized budgeting process. There is a substantial flow of goods between NCR Corporation and its domestic and foreign subsidiaries and branches; all NCR Corporation's foreign sales are conducted through its foreign subsidiaries and foreign branches. The business conducted by NCR Cor-

poration throughout the world, both directly and through its domestic and foreign subsidiaries, is a single, integrated unitary business. All the foreign subsidiaries are unitary with NCR Corporation and the federal consolidated group. NCR Corporation contends that its Subpart F Income is not business income under Section 7-4-2(A) NMSA 1978 and is not apportionable under Section 7-4-10. With respect to the disputed foreign dividends, foreign royalties and foreign interest income, NCR Corporation contends that, notwithstanding the following sentence, said income is not apportionable under Section 7-4-10 for both constitutional and statutory reasons. NCR agrees that said dividends, royalties and interest arise from transactions and activities in the regular course of NCR's trade or business, including from tangible and intangible property, the acquisition and management of which constitute integral parts of NCR's regular trade or business operations.

9. The operating income from the foreign branches is included in NCR Corporation's federal taxable income. Since these foreign branches are part of NCR Corporation, the Internal Revenue Service requires their income and or loss to be included by NCR Corporation when calculating its federal taxable income. NCR Corporation does not contest any aspect of New Mexico's taxation of this branch income because in its view, New Mexico, in applying its apportionment formula, properly included all factors which gave rise to the branch income.

10. From its foreign subsidiary corporations, NCR Corporation receives patent royalty income, interest income and dividend income. Included in NCR Corporation's federal taxable income are the royalties, interest and dividends received by NCR Corporation from its foreign subsidiaries. The foreign subsidiaries, themselves, do not pay U.S. income tax.

11. In conducting its worldwide business, NCR Corporation develops, acquires, owns and uses patents and

patent rights, both in the United States and in foreign countries. In addition, NCR Corporation registers patents and licensing agreements in foreign countries. Pursuant to those patent registration and licensing agreements, NCR Corporation grants to its foreign subsidiaries the right to manufacture and sell business machines and equipment patented by NCR Corporation and NCR Corporation receives royalty income from its foreign subsidiaries. The foreign royalty payments made to NCR Corporation by its foreign subsidiaries are based upon the amount of sales by these subsidiaries in foreign countries.

12. NCR Corporation provides its foreign subsidiaries with capital; manufactured products; plant design; operations, service and sales training; and other support. The foreign subsidiaries incur payroll and property expenses in order to generate sales of NCR Corporation's products. When NCR Corporation's foreign subsidiaries pay royalties to NCR Corporation, the foreign country where this income is earned by NCR Corporation has the right to tax NCR Corporation on the gross amount of the royalties paid. When this right is exercised, it is usually accomplished through a withholding tax mechanism, whereby NCR Corporation's tax liability is paid over by the foreign subsidiary to the foreign country on behalf of NCR Corporation. Under contracts pursuant to which royalty payments are made, the royalty payments from foreign subsidiaries must be made to NCR Corporation even if such subsidiaries are incurring losses. The rate of tax imposed by the foreign country upon NCR Corporation is usually determined by a treaty between the United States and that foreign country, and, if there is no tax treaty, then under the laws of the foreign country.

13. NCR Corporation also receives interest payments from foreign sources. There are four types of interest payments received by NCR Corporation. These payments consist of interest from loans to its foreign subsidiaries; interest from its foreign subsidiaries for financing receivables; interest income pursuant to Section 904(d) of the

Internal Revenue Code of 1986; and interest received from unrelated third parties, namely banks where NCR Corporation itself has funds on deposit within foreign countries. NCR Corporation registers certain foreign loan agreements in foreign countries. NCR Corporation's interest income from foreign sources is also subject to the foreign withholding tax mechanisms in the same manner as the royalty payments. Under NCR Corporation's loan agreements interest must be paid to NCR Corporation by its foreign subsidiaries even if the foreign subsidiaries are incurring losses.

14. NCR Corporation receives actual dividends from its foreign subsidiaries. NCR Corporation's foreign subsidiaries from time to time declare and pay actual dividends from earnings to shareholders, principally NCR Corporation. NCR Corporation's dividends from foreign sources are also subject to the foreign withholding tax mechanisms in the same manner as the royalty payments. In addition, NCR Corporation is required to include "deemed dividends" in its computation of federal taxable income (these are generally referred to as Subpart F Income). The Subpart F provisions, set forth in Sections 951, *et seq.*, of the Internal Revenue Code, require NCR Corporation to include in its federal gross income items which it has not actually received but is rather deemed to have received as a result of being a U.S. shareholder of a controlled foreign corporation. The Subpart F Income deemed to have been received by NCR Corporation is attributable to various items set forth in Sections 951, *et seq.*, of the Internal Revenue Code and is measured by certain types of undistributed income earned by the foreign subsidiaries.

15. The gross amount of the payments received by NCR Corporation in the form of royalties, interest and dividends is gross income earned directly by NCR Corporation and was for all relevant periods treated as such in each of the foreign jurisdictions in which NCR Cor-

poration and its subsidiaries conduct business. Consequently, NCR Corporation is subject to the taxing jurisdiction of each of the host countries as to this income. Most foreign countries which tax this income do so by imposing a flat tax upon the gross amount of the royalties, interest and dividends received by NCR Corporation from its subsidiaries in the foreign countries. These countries collect the tax by requiring the payor to withhold and pay over the amount of NCR Corporation's tax liability. The various foreign countries' withholding tax rates applicable to NCR Corporation's royalties, interest and dividends range from zero percent (0%) to forty percent (40%) of the gross amount of the payment. The tax is imposed by the laws of the foreign country and the rate is determined by treaty or, in the event there is no such treaty, then by the laws of the foreign country. These taxes are completely unrelated to the income taxes paid by the foreign subsidiaries on their operating income.

16. In 1983 there were six foreign subsidiaries of NCR Corporation which made either interest, royalty or dividend payments to NCR Corporation and incurred losses. All six made interest payments totaling $831,623. Four of these six also made royalty payments to NCR Corporation totaling $25,108. None made dividend payments. In 1986 there were five foreign subsidiaries of NCR Corporation which made either interest, royalty or dividend payments to NCR Corporation and incurred losses. All five made interest payments totaling $203,253. None of these companies made any royalty or dividend payments to NCR Corporation that year. [On or before September 28, 1990 NCR will provide TRD any proposed stipulation and supporting schedules relating to dividend, interest and royalty paying foreign subsidiaries which incurred losses in the years 1981, 1982, 1984, 1985 and 1987. The form of the proposal will follow the form set forth above in this paragraph. These numbers will be subject to prompt audit by TRD. If TRD does not receive such a proposal by September 28, 1990, the record

in this case will be closed on this issue. If TRD does receive a timely proposal, on or before October 15, 1990, TRD will stipulate to facts on this issue that are supported by numbers TRD can confirm.]

17. The New Mexico Taxation and Revenue Department (TRD) is the agency of the state of New Mexico responsible by law for the collection of taxes and enforcement of the state's tax laws.

18. On October 21, 1985 TRD issued Assessment Number 5909 assessing NCR Corporation a total of $23,071.17 in taxes due for 1982 ($16,049.51 in tax plus penalty of $1,604.95 and interest of $5,416.71 to June 15, 1985).

19. On October 26, 1985 TRD issued Assessment Number 5929 assessing NCR Corporation a total of $24,469.01 in taxes due for 1983 ($19,005.05 in tax plus penalty of $1,900.51 and interest of $3,563.45 to June 15, 1985).

20. On October 29, 1985 TRD issued Assessment Number 5932 assessing NCR Corporation a total of $7,677.41 in taxes due for 1981 ($4,905.69 in tax plus penalty of $490.57 and interest of $2,281.15 to June 15, 1985).

21. On November 18, 1985 NCR Corporation filed a timely protest of Assessment Numbers 5909, 5929 and 5932.

22. On January 25, 1990 TRD issued Assessment Number 7846 assessing NCR Corporation the following taxes and interest for each of the following years:

	Tax	Interest	Total
1984	$ 14,200.18	$ 10,472.63	$ 24,672.81
1985	$ 14,520.03	$ 8,530.52	$ 23,050.55
1986	$ 32,032.00	$ 14,014.00	$ 46,046.00
1987	$323,712.00	$ 93,067.20	$416,779.20
TOTAL:	$384,464.21	$126,084.35	$510,548.56

23. On February 23, 1990 NCR Corporation filed a timely protest of Assessment Number 7846.

24. The protests of assessments 5909, 5929, 5932 and 7846 have been consolidated and will be heard together by the administrative hearing officer.

25. Interest on all taxes assessed continues to run at the rate set by New Mexico law (currently 15 percent per year).

26. NCR Corporation's position is that (i) its disputed foreign source income (royalties, interest and dividends) is neither taxable nor apportionable by New Mexico because that income is earned by NCR Corporation in foreign countries where such income is subject to an unapportioned tax and because that income is not attributable to New Mexico, and (ii) its Subpart F Income may not be taxed by New Mexico and may not be subjected to apportionment by the state of New Mexico. If it held that this foreign source income is taxable by New Mexico and therefore apportionable, then it is NCR Corporation's position that the Due Process, Equal Protection and Commerce Clauses of the United States Constitution are violated if the factors which gave rise to the income are not included in the apportionment factors. Finally, NCR Corporation asserts that for tax years 1984 and 1985 the statute of limitations expired before the assessments were issued.

27. TRD's position is that all the unitary business income (from both domestic and foreign sources) and the Subpart F Income of NCR Corporation and the members of its consolidated group are properly includable in NCR Corporation's New Mexico apportionable income and subject to tax by this state. TRD also asserts that its use of apportionment factors based solely on NCR Corporation's consolidated group's factors does not violate the United States Constitution or state or federal law. Finally,

TRD claims that, under Section 7-1-18(D) NMSA 1978, the statute of limitations had not expired before the assessments for tax years 1984 and 1985 had issued. TRD agrees that $70,040,627 of Section 78 foreign dividend gross-up was mistakenly reported on Line 8 of Schedule C of NCR Corporation's 1982 United States Corporate Income Tax Return Form 1120 as Subpart F Income and all relevant entries for 1982 in this stipulation have been adjusted by TRD to reflect the proper reporting of this income. TRD also agrees that all penalties assessed (for tax years 1981, 1982 and 1983) will be abated.

28. Upon audit the state of New Mexico disallowed all of the income adjustments which were claimed by NCR Corporation with the exception of Section 78 gross-up. Those income adjustments included NCR Corporation's reduction of federal taxable income by the amount it actually received from foreign source royalty, interest and dividend payments and the amount it was deemed to have received as Subpart F Income. New Mexico is not attempting to tax the operating income of NCR's foreign subsidiaries, but is attempting to tax the income received by NCR Corporation from the payment to it by its foreign subsidiaries of royalties, dividends and interest and its Subpart F Income.

29. The foreign-source dividends, interest and royalties earned by NCR Corporation from its unitary foreign subsidiaries for each of the years 1981 through 1987 are as follows:

"FOREIGN SOURCE" GROSS INCOME RECEIVED BY PARENT (NCR CORPORATION)

1981	
Dividends	$ 34,416,543
Interest	$ 21,730,821
Royalties	$ 40,590,222
TOTAL:	$ 96,737,586
1982	
Dividends	$ 35,214,185
Interest	$ 28,320,913
Royalties	$ 47,897,917
TOTAL:	$111,433,015
1983	
Dividends	$ 45,963,133
Interest	$ 19,445,024
Royalties	$ 54,464,120
TOTAL:	$119,872,277
1984	
Dividends	$ 50,167,524
Interest	$ 16,157,574
Royalties	$ 73,833,474
TOTAL:	$140,158,572
1985	
Dividends	$ 63,994,155
Interest	$ 7,836,796
Royalties	$ 86,296,270
TOTAL:	$158,127,221
1986	
Dividends	$ 73,289,419
Interest	$ 11,765,099
Royalties	$100,039,780
TOTAL:	$185,094,298
1987	
Dividends	$246,229,126
Interest	$ 5,458,622
Royalties	$149,774,394
TOTAL:	$401,462,142

30. NCR Corporation's total gross foreign source income on which foreign taxes were and were not actually withheld, the amount of foreign withholding taxes paid on NCR's behalf by its foreign subsidiaries, the total Foreign Tax Credit taken by NCR Corporation on its United States Corporate Income Tax returns (Section 901 of the Internal Revenue Code), and the amount of this U.S. tax credit attributable to foreign taxes actually paid by NCR Corporation's foreign subsidiaries on NCR's behalf for each year are as follows:

FOREIGN TAX DATA

	NCR's Gross Foreign Source Income on Which *No* Foreign Tax Was Withheld	NCR's Gross Foreign Source Income on Which Foreign Tax Was Withheld	Total Foreign Withholding Tax Paid for NCR by its Subsidiaries	NCR's Total United States Income Tax Foreign Tax Credit	Tax Credit Attributable to Foreign Taxes Paid by Foreign Subsidiaries
1981					
Dividends	$ 4,032,324	$ 30,384,219	$ 3,653,849		
Interest	$ 4,526,192	$ 17,204,629	$ 4,379,925		
Royalties	$ 27,594,277	$ 12,995,945	$ 1,463,093		
TOTAL:	$ 36,152,793	$ 60,584,793	$ 9,496,867	$ 43,656,914	$ 9,858,627
1982					
Dividends	$ 15,533,955	$ 19,680,230	$ 3,901,911		
Interest	$ 13,327,390	$ 14,993,523	$ 3,967,400		
Royalties	$ 29,637,674	$ 18,260,243	$ 1,840,217		
TOTAL:	$ 58,499,019	$ 52,879,996	$ 9,709,528	$110,391,259	$10,160,348
1983					
Dividends	$ 21,181,884	$ 24,781,249	$ 4,726,496		
Interest	$ 14,295,341	$ 5,149,683	$ 1,675,106		
Royalties	$ 21,856,328	$ 32,607,792	$ 2,380,722		
TOTAL:	$ 57,333,553	$ 62,538,724	$ 8,782,324	$ 62,959,190	$ 9,505,881

1984					
Dividends	$ 12,614,739	$ 37,552,785	$ 5,886,324		
Interest	$ 12,013,508	$ 4,144,066	$ 1,477,900		
Royalties	$ 45,162,055	$ 28,671,419	$ 2,753,448		
TOTAL:	$ 69,790,303	$ 70,368,270	$10,117,672	$ 84,011,578	$11,017,045
1985					
Dividends	$ 10,346,048	$ 53,648,107	$ 7,012,304		
Interest	$ 5,776,154	$ 2,060,642	$ 1,163,772		
Royalties	$ 46,260,141	$ 40,036,129	$ 3,318,157		
TOTAL:	$ 62,382,343	$ 95,744,878	$11,494,233	$147,389,608	$12,230,536
1986					
Dividends	$ 11,985,830	$ 61,303,589	$ 8,356,901		
Interest	$ 9,811,822	$ 1,665,370	$ 361,892		
Royalties	$ 57,313,800	$ 42,725,980	$ 3,455,604		
TOTAL:	$ 79,112,052	$105,694,939	$12,174,397	$ 83,805,470	$12,432,825
1987					
Dividends	$ 10,988,279	$235,240,847	$28,213,145		
Interest	$ 3,856,577	$ 1,602,045	$ 404,848		
Royalties	$ 91,631,669	$ 58,142,725	$ 4,141,767		
TOTAL:	$106,476,525	$294,985,617	$32,780,715	$248,512,105	$33,216,735

31. The amount of "gross-up" under Section 78 of the United States Internal Revenue Code allowed by TRD as a deduction from apportionable income in the following years is as follows:

GROSS-UP

1981	$ 27,934,332
1982	$ 91,828,291
1983	$ 45,777,859
1984	$ 61,647,910
1985	$122,888,999
1986	$ 58,425,843
1987	$205,293,818

32. The state of New Mexico is also including in NCR Corporation's apportionable income amounts deemed as Subpart F Income in the following amounts for each year:

SUBPART F INCOME

1981	$ 3,063,608
1982	$ 61,471,050
1983	$ 16,274,706
1984	$ 19,783,668
1985	$ 87,301,962
1986	$ 9,325,013
1987	$122,241,498

33. If NCR Corporation prevails in its primary position, some or all of the income specified in paragraphs 29 and 32 will have to be subtracted from the total annual apportionable income set forth in this paragraph. If TRD's position is sustained in full, then NCR Corporation's total apportionable income for purposes of apportionment to and taxation by New Mexico (calculated by starting with Federal Taxable Income from line 30 Form

1120, which includes the income set forth in paragraphs 29 and 32 of this Stipulation, and excluding the gross-up specified in paragraph 31) for each year is as follows:

NCR's NET APPORTIONABLE INCOME
(INCLUDING ALL DISPUTED FOREIGN SOURCE AND SUBPART F INCOME)

1981	$153,116,607
1982	$214,663,629
1983	$277,399,602
1984	$316,859,147
1985	$335,401,046
1986	$147,573,952
1987	$489,545,492

34. NCR Corporation's and its entire federal consolidated group's payroll, property and sales in New Mexico for each year are as follows:

APPORTIONMENT
FACTORS-NUMERATOR-NEW MEXICO

	Payroll	Property	Sales
1981	$1,774,178	$4,188,760	$10,125,264
1982	$2,027,562	$4,539,852	$12,252,046
1983	$2,168,917	$4,303,429	$13,220,530
1984	$2,063,525	$3,568,104	$13,657,684
1985	$2,197,202	$4,450,091	$12,809,472
1986	$2,415,845	$4,958,596	$13,767,421
1987	$2,384,653	$4,436,036	$ 9,066,316

35. NCR Corporation's and its entire federal consolidated group's payroll, property and sales (to be included in the denominator for calculation of the respective New Mexico apportionment factors for each year if the Taxa-

tion and Revenue Department's position is correct in its entirety), including (in the "sales" column) the income specified in paragraph 29 of this Stipulation, are set forth below (in this paragraph 35). If NCR prevails in its protest, the amount of some or all of the payroll, property and sales numbers for each respective year will have to be increased.

APPORTIONMENT FACTORS-DENOMINATOR
FEDERAL CONSOLIDATED EVERYWHERE

	Payroll	Property	Sales
1981	$ 760,371,034	$1,697,142,638	$2,190,686,114
1982	$ 790,035,516	$1,756,345,462	$2,739,704,257
1983	$ 861,962,023	$1,767,924,904	$2,660,154,707
1984	$ 847,483,268	$1,788,931,289	$3,058,101,729
1985	$ 995,063,950	$1,912,333,615	$3,263,359,784
1986	$1,081,681,303	$1,905,794,350	$3,252,504,941
1987	$1,126,931,270	$1,979,005,806	$4,004,618,027

36. In the event the Taxation and Revenue Department's position is sustained in its entirety, then NCR's tax liability to the state of New Mexico (exclusive of interest on the liability) is calculated as follows:

	NCR's Net Apportionable Income (¶ 33)		NCR's Apportionment Factor (the average of the ratios in ¶¶ 34 & 35)		NCR's N.M. Taxable Income	NCR's N.M. Tax Liability
1981	$153,116,607	x	0.3141%	=	$ 480,939	$19,238
1982	$214,663,629	x	0.3208%	=	$ 743,607	$29,744
1983	$277,399,602	x	0.3307%	=	$ 917,360	$44,033
1984	$316,859,147	x	0.2965%	=	$ 939,487	$45,095
1985	$335,401,046	x	0.2820%	=	$ 945,831	$45,400
1986	$147,573,952	x	0.3023%	=	$ 446,116	$21,414
1987	$489,545,492	x	0.2207%	=	$1,080,427	$62,112

37. The total annual payroll, property and sales of NCR Corporation's foreign subsidiaries which paid royalties, interest or dividends to NCR are:

RELEVANT FOREIGN SUBSIDIARIES' PAYROLL, PROPERTY AND SALES

	Payroll	Property	Sales
1981	$463,354,241	$1,157,487,446	$1,469,269,547
1982	$406,853,477	$1,052,926,261	$1,465,497,507
1983	$420,096,582	$1,001,081,459	$1,561,878,057
1984	$387,405,569	$ 986,672,187	$1,633,510,398
1985	$420,680,964	$1,036,141,621	$1,838,679,888
1986	$560,495,875	$1,156,533,955	$2,308,742,008
1987	$658,152,879	$1,310,252,532	$2,815,785,020

38. The total annual payroll, property and sales of 1) NCR Corporation's foreign subsidiaries which paid royalties, interest or dividends to NCR (from paragraphs 37), *plus* 2) NCR's United States federal consolidated group (from paragraph 35) are:

	Payroll	Property	Sales
1981	$1,223,725,275	$2,854,630,084	$3,659,955,661
1982	$1,196,888,993	$2,809,271,723	$4,205,201,764
1983	$1,282,058,605	$2,769,006,363	$4,222,032,764
1984	$1,234,888,837	$2,775,603,476	$4,693,612,127
1985	$1,415,744,914	$2,948,475,236	$5,102,039,672
1986	$1,642,177,178	$3,062,328,305	$5,561,246,949
1987	$1,785,084,149	$3,289,258,338	$6,820,403,047

39. If the Taxation and Revenue Department prevails in part and all the disputed income is included in the apportionable tax base and if NCR Corporation prevails in part and the property, payroll and sales of the relevant subsidiaries are included in the apportionment factors, then NCR's tax liability (exclusive of interest on the lia-

bility) to the state of New Mexico is calculated as follows:

	NCR's Net Apportionable Income (¶ 33)	x	NCR's Foreign Factor Representation in Apportionment Factors (the average of the ratios in ¶¶ 34 & 38)	=	NCR's N.M. Taxable Income	NCR's N.M. Tax Liability
1981	$153,116,607	x	0.1894%	=	$290,003	$11,600
1982	$214,663,629	x	0.2075%	=	$445,427	$17,817
1983	$277,399,602	x	0.2126%	=	$589,752	$28,308
1984	$316,859,147	x	0.1955%	=	$619,460	$29,734
1985	$335,401,046	x	0.1857%	=	$622,840	$29,896
1986	$147,573,952	x	0.1855%	=	$273,750	$13,140
1987	$489,545,492	x	0.1338%	=	$655,012	$33,921

40. The gross revenue income and the net income before taxes of all of NCR Corporation's foreign subsidiaries which paid royalties, dividends or interest to NCR each year is:

RELEVANT FOREIGN SUBSIDIARIES' INCOME

	Gross Revenue	Net Income Before Taxes
1981	$1,469,269,547	$169,020,048
1982	$1,465,497,507	$208,654,641
1983	$1,561,878,057	$186,243,865
1984	$1,633,510,398	$232,072,220
1985	$1,838,679,888	$238,480,034
1986	$2,308,742,008	$349,187,493
1987	$2,815,785,020	$468,960,225

DISCUSSION AND ANALYSIS

A. *Background*

This case presents for decision complex issues concerning how the income of a multistate and multinational corporation can be apportioned among the various states. In its protest, NCR has challenged the imposition of New Mexico's corporate income tax upon a proportionate share of NCR Corporation's income received in the form of royalties, interest and dividends from its foreign subsidiaries. NCR Corporation argues that the Foreign Commerce Clause of the United States Constitution acts as an absolute bar to New Mexico's inclusion of NCR's foreign-sourced income in the New Mexico apportioned tax base. In the alternative, NCR posits that the method by which New Mexico imposes its tax is unconstitutional under the Commerce Clause and the Due Process Clause of the United States Constitution and the Due Process Clause of the New Mexico Constitution. A third issue concerns New Mexico's treatment of what is called Subpart F income. Finally, NCR Corporation asserts that, should it prevail on its other arguments, its assessed tax liability would be reduced sufficiently (to where it would not be considered to have underreported its corporate income tax liability by more than 25%) so as to bar the Department's assessment for tax years 1984 and 1985, pursuant to the statute of limitations at Sections 7-1-18(A) and (D) NMSA 1978. No penalty on any of the assessments is at issue as the Department has agreed to abate any penalty assessed.

In order to provide a background for the discussion of these issues, a brief review of the interrelationship between the Foreign Commerce Clause, the Due Process Clause and the state's ability to tax income generated in foreign commerce in the context of the application of the unitary business principle will be reviewed. Additionally, New Mexico's statutory method for calculating corporate income

taxes under the Uniform Distribution of Income for Tax Purposes Act (UDITPA) Sections 7-4-1 to 7-4-21 NMSA 1978 will also be reviewed.

It is fundamental under both the Due Process and Commerce Clauses of the Constitution that a state may not, when imposing an income-based tax, tax value earned outside of its borders. *See, Asarco, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982). When dealing with income that has been earned by a multistate and multinational taxpayer, determining what income has been earned by that taxpayer within a particular state can be extremely complicated and has generated a significant amount of constitutional litigation in the U.S. Supreme Court. *See, e.g., Asarco; Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983); *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425 (1980); *F.W. Woolworth Co. v. Taxation and Revenue Department*, 458 U.S. 354 (1982); *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980); *Moorman Manufacturing Co. v. Baer*, 437 U.S. 267 (1978), and many others. Because of the difficulty of precisely measuring a state's properly apportioned portion of a multistate or multinational taxpayer's income, the Supreme Court has long held that the Constitution imposes no single formula on the states, *Wisconsin v. J.C. Penney*, 311 U.S. 435, 445 (1940), and has placed upon a taxpayer challenging a state's formula, the burden of showing by clear and cogent evidence that a state tax results in the taxation of extraterritorial values. *Exxon Corporation, supra*, 447 U.S. at 221. Historically, states attempted to account for their share of taxable income based upon systems of separate accounting whereby a company's income earned within the geographical boundaries of the state was determined based on formal corporate entities or on an attempt to segregate transactions conducted within the state. This methodology, called separate accounting, has largely been abandoned in modern times because separate accounting

was subject to manipulation and imprecision and often ignored or captured inadequately the many subtle and often unquantifiable transfers of value that take place among the components of a large, complex enterprise. *See, generally, Mobil Oil Corp.*, 445 U.S. at 438-439. As a result of the inadequacy of the separate accounting concept, the unitary business concept evolved. The unitary business principle generally disregards territorial boundaries and corporate structure issues. The unitary concept requires viewing a business enterprise as a single unit irrespective of whether the enterprise crosses geographic boundaries or its business is conducted through separate corporate entities. Once the scope of the unitary business is defined, the taxable income of the total unitary enterprise is determined and various apportionment formulas may be applied to approximate the unitary business income which is reasonably related to the business's activities conducted within the taxing jurisdiction based on various objective measures of the taxpayer's activities both within and without the taxing jurisdiction. *See, e.g., Moorman Manufacturing Co. v. Baer*, 437 U.S. 267 (1978). The Supreme Court long ago upheld the constitutionality of the basic unitary business concept. *See, e.g., Hans Rees' Sons, Inc. v. North Carolina, ex rel., Maxwell*, 283 U.S. 123 (1931); *Bass, Ratcliff and Gretson, Ltd. v. State Tax Commission*, 266 U.S. 271 (1924); *Underwood Typewriter Company v. Chamberlain*, 254 U.S. 113 (1920). More recently, the U.S. Supreme Court has noted that "the linchpin of apportionability in the field of state income taxation is the unitary business principle." *Mobil Oil Corp.*, 445 U.S. at 439. In other words, it is the unitary business principle which provides the constitutional basis for the use of an apportionment formula by the states to apportion to the states their appropriate share of corporate income.

The most common apportionment formula is the three-factor apportionment formula found in the UDITPA

which, with minor variations, over half of the states, including New Mexico, have adopted. *See*, Sections 7-4-10 through 7-4-18 NMSA 1978. The UDITPA formula requires the creation of three fractions: 1) the value of a corporation's property in a given state (the property numerator) divided by its property everywhere (the property denominator); 2) the corporation's payroll in the state (the payroll numerator) divided by its payroll everywhere (the payroll denominator); 3) and the taxpayer's sales in the state (the sales numerator) divided by its sales everywhere (the sales denominator). These three fractions are then added together and divided by three to arrive at a fraction or multiplier which is applied to the corporation's total apportionable income to arrive at the portion which can be taxed by the given state.

The unitary business concept has been implemented somewhat differently in various states with regard to the division of income of multinational operations. For instance, California has adopted what is called "worldwide combined reporting," which involves the combination of both domestic (U.S.) corporations, as well as foreign corporations, so long as they constitute part of a unitary business. New Mexico law, Section 7-2A-8.3(B) NMSA 1978 prohibits worldwide combined reporting and does not include foreign corporations in its definition of the reporting taxpayer. Rather, under New Mexico's system,[1] the reporting taxpayer is the federal consolidated group, in this instance, NCR and its domestic subsidiaries, but excluding NCR's foreign subsidiaries. Under this system during the years in question, New Mexico calculated NCR's corporate income tax by the following method: 1) start with federal taxable income of the federal consolidated group; 2) deduct foreign dividend gross-up, income from United States obligations and "nonbusiness" income allocated to other

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[1] Systems like New Mexico's have been characterized as a hybrid system. *See, Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 at 168, n. 5 (1983).

states; 3) apportion this total apportionable income in accordance with the three-factor formula specified by UDITPA to determine New Mexico's apportioned share; and 4) apply the tax rate to this New Mexico taxable income to arrive at the tax due. *See,* Sections 7-2A-2(C), 7-2A-2(J)(2), 7-2A-8, 7-2A-3, 7-4-10 through 7-4-18 NMSA 1978 as in effect for the tax years 1981 through 1987.

B. *Application of the Foreign Commerce Clause.*

The primary issue presented is whether New Mexico may impose its corporate income tax upon a proportionate share of NCR Corporation's income received in the form of royalties, interest and dividends from its foreign subsidiaries. NCR Corporation argues that the Foreign Commerce Clause of the United States Constitution precludes New Mexico's tax.

Under New Mexico's "hybrid" scheme for corporate income tax reporting, which defines the taxpayer as the federal consolidated group, New Mexico is not seeking to directly tax the income of any of NCR Corporation's foreign subsidiaries. Rather, New Mexico seeks to tax an apportioned share of the U.S. parent corporation's income which it received in the form of royalties, interest and dividends from its unitary foreign subsidiaries.

It is beyond cavil that the foreign source of the income itself does not create a *per se* bar to state taxation. *See, Mobil Oil Corp. v. Comm'r of Taxes of Vermont,* 445 U.S. 425 (1980) at 439-440. Likewise, it is not disputed that once it is established that a unitary business exists, states may tax a proportionate share of the business's income, providing that that tax imposition meets certain constitutional standards. It is the application of those standards to the income in question which is in dispute. There is no dispute as to the amount, character or source of the income at issue.

The Foreign Commerce Clause is found in art. I, § 8, cl. 3 of the United States Constitution. It provides that "Congress shall have the power to regulate commerce with the foreign nations . . ."

The factual predicate for NCR's contention that New Mexico's attempt to tax NCR's royalty interest and dividend income from its foreign subsidiaries is found in paragraphs 10, 11, 12, 13, 14 and 15 of the findings of fact. These paragraphs describe the nature of NCR Corporation's income from its foreign subsidiaries and the methods by which they are taxed. Paragraph 15 is of particular interest because it contains the kernel of NCR's argument. It was agreed by the parties that the royalties, interest and dividends received by NCR Corporation from its foreign subsidiaries were treated as gross income of NCR Corporation, thus subjecting NCR Corporation to the taxing jurisdiction of each of the host countries with regard to this income. Most of the countries which tax this income do so by imposing a flat tax upon the gross amount of royalties, interest and dividends received by NCR Corporation and the tax is generally collected by requiring the subsidiary paying the royalties, interest or dividends to withhold and pay over the amount of NCR Corporation's tax liability. The withholding tax applicable to NCR's foreign source income ranges from 0% to 40%, depending on tax treaties or the laws of the host foreign country. This withholding tax imposed upon NCR Corporation is completely separate and apart from any tax the foreign governments may impose directly upon the foreign subsidiaries upon their income.

Based upon the fact that 100% of NCR's foreign source royalty, interest and dividend income is subject to the taxing jurisdiction of the foreign countries in which that dividend is earned, NCR contends that any attempt by a state to impose its tax, even on an apportioned basis, constitutes multiple taxation which is absolutely barred

under the United States Supreme Court's interpretation of the operation of the Foreign Commerce Clause in the seminal case of *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979).

Japan Line involved an attempt by the county of Los Angeles to impose property tax upon the value of cargo containers belonging to a Japanese shipping company's vessels which were present in California on the lien date for *ad valorem* property taxes. The cargo containers were used exclusively for transporting cargo in foreign commerce and, like the ships they were used in, they were owned by Japanese companies which have their place of business and commercial domicile in Japan. Underpinning the Court's decision was its recognition that with respect to *ad valorem* taxes, it was the "custom of nations" to allow the country of domicile to tax the shipping containers on their full value. *Id.* at 448.

The Court's analysis of the Foreign Commerce Clause began with its consideration of the restrictions which the Interstate Commerce Clause places upon states' ability to tax interstate commerce. When purely interstate commerce is involved, a state tax is lawful when it: 1) is applied to an activity having a substantial nexus with the taxing state; 2) is fairly apportioned; 3) is fairly related to the services provided by the state; and 4) does not discriminate against interstate commerce. *See, Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). However, when a state seeks to tax instrumentalities of foreign commerce, two additional considerations beyond those of *Complete Auto Transit* apply. "A court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the federal government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Japan Line*, 441 U.S. at 452. In applying these tests, the Court concluded that Califor-

nia's apportioned property tax resulted in actual multiple taxation and prevented the federal government from speaking with one voice with regard to its foreign relations and foreign trade. The Court thus invalidated California's tax under both of the additional foreign commerce clause considerations.

If *Japan Line* were the Supreme Court's last word on the application of the Foreign Commerce Clause to states' efforts to impose their apportioned income taxes to foreign source income, there would be no need for further analysis, and NCR would prevail upon its claim, based upon the fact that it is subject to income taxation on the foreign source income by its foreign host countries as well as in the state of New Mexico, constituting prohibited multiple taxation. *Japan Line*, however, must be read in conjunction with the Court's more recent pronouncements concerning the application of the Foreign Commerce Clause in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), which extensively analyzed the application of *Japan Line* to state taxation of corporation income. *Container* involved in [sic] the application of California's corporate franchise tax to a Delaware corporation doing business in California and which also had subsidiaries operating overseas. *Container Corporation of America* attempted to exclude from California's consideration its property, payroll and sales of its foreign subsidiary corporations in calculating California franchise tax. California employs a different corporate income taxation scheme than New Mexico's, called the worldwide combined reporting system, but both New Mexico's and California's systems rely upon the unitary business concept as the predicate for combining the incomes of all or at least a portion of the businesses which are considered unitary prior to the state's applying an apportionment formula to the income to determine its taxable share.

The Court in *Container Corporation* extensively analyzed the application of *Japan Line* to the issue of state

taxation of foreign-sourced corporation income. NCR Corporation's position that *Japan Line* continues to operate as an absolute bar to multiple taxation by both states and foreign nations of income can no longer be credibly maintained given the Court's analysis in *Container Corporation*. As in *Japan Line*, the *Container* court found that there was actual double taxation, "in the sense that some of the income taxed without apportionment by foreign nations as attributable to appellant's foreign subsidiaries was also taxed by California as attributable to the state's share of the total income of the unitary business . . ." 463 U.S. at 187. It also noted that the double taxation stems from a serious divergence in the taxing schemes adopted by the state and the foreign taxing authorities, and the taxing method adopted by the foreign authorities was consistent with accepted international practice. *Id.* at 187. The Court went on to note that,

> "Nevertheless, there are also a number of ways in which this case is clearly distinguishable from *Japan Line*. First, it involves a tax on income rather than a tax on property. We distinguish property from income taxation in *Mobil Oil Corp.*, 445 U.S. at 444-446 and *Exxon Corp.*, 447 U.S. at 228-229, suggesting that "the reasons for allocation to a single situs that often apply in the case of property taxation carry little force" in the case of income taxation. [Citation omitted]. Second, the double taxation in this case, although real, is not the "inevitable" result of the California taxing scheme [citing *Japan Line*] . . . The third difference between this case and *Japan Line* is that the tax here falls, not on the foreign owners of an instrumentality of foreign commerce, but on a corporation domiciled and headquartered in the United States.

Container Corp., 463 U.S. at 188. Finding that these distinctions added up to a "constitutionally significant

difference," the *Container* Court allowed the state's double taxation of corporate income by both foreign governments and states to stand. *Id.* at 189-197.

In applying the Court's rationale for distinguishing *Japan Line* and *Container* to the facts of this case, it is clear that the first and third bases which the *Container* Court relied upon to distinguish *Japan Line* are present in this case. Specifically, as in *Container*, this case involves a tax on income rather than the tax on property, and the tax falls here on a corporation domiciled and headquartered in the United States, rather than on the foreign owners of an instrumentality of foreign commerce. It is the second ground, whether or not multiple taxation is "inevitable" upon which NCR Corporation relies. It must be observed at this point of the analysis that in its *Container* decision, the Supreme Court gave no indication as to the weight to be accorded to each of the three factors by which it distinguished the facts in *Container* from *Japan Line*. NCR assumes that the existence of one factor, the inevitability of multiple taxation, is fatal under the Foreign Commerce Clause, but this is not at all clear from the *Container* decision.

The Court in *Container Corporation* found that actual double taxation was the result of the application of two distinct methods of allocating the income of the multinational enterprise being applied by foreign governments and by the states, and it stated whether the combination of the two methods results in double taxation is dependent solely on the facts of the individual case. *Id.* at 188. Here also, we have two different methodologies being applied. On one hand, foreign governments claim the right to tax the income at rates varying from 0% to 40%. States also assert jurisdiction to tax a proportionate share of the same income. NCR asserts that double taxation is "inevitable," thus violating the Foreign Commerce Clause in contravention of *Japan Line*, because the foreign governments claim the jurisdiction to tax NCR on 100% of its foreign source income. *See*,

Reply Brief of NCR, pp. 5-6. Any state tax imposed upon the same income "inevitably" results in double taxation. The Department argues that double taxation is not inevitable because any double taxation is the result of two different methods of taxation, and whether double taxation actually occurs is dependent on the facts of the individual case.

The Supreme Court in *Container* did not clearly explain the concept of "inevitability." In *Japan Line,* it was the custom of nations for the country of domicile to tax 100% of the value of the cargo containers. Thus, any attempt by California to impose any tax on those same containers "inevitably" resulted in multiple taxation. Here, although NCR asserts that foreign governments tax 100% of the foreign source income, the actual tax rates stipulated by the parties show that the foreign withholding taxes are imposed at rates ranging from 0% to 40%. Finding of Fact No. 15. A tax rate of zero percent sounds suspiciously like a decision to exempt entirely from taxation. Thus, unlike in *Japan Line,* it is apparently not the consistent practice, or "custom of nations" for foreign governments to tax the royalty, interest and dividend income of nondomiciliary parent corporations derived from subsidiaries domiciled in the foreign country. Because the concept of "inevitability" is so difficult to discern from the Supreme Court's decision in *Container,* a more objective basis for analyzing this issue is to examine whether under the facts of the individual case, double taxation of the income at issue is always the result. As noted above, although host foreign governments may have the jurisdiction to impose an unapportioned tax upon all of NCR Corporation's royalty, interest and dividend income, the actuality of that tax is significantly different. As set forth in the Department's answer brief at page 7, based upon the figures found in Findings of Fact 29 and 30, a significant portion of NCR's foreign source income was not taxed by any foreign country during the years in question. The amounts not taxed and the years

are set forth as follows: 1981—37%; 1982—52%, 1983—48%, 1984—50%, 1985—39%, 1986—43%, and 1987—27%. On this basis, it cannot be concluded that multiple taxation is inevitable. Rather, "whether the combination of the two methods results in the same income being taxed twice or in some portion of income not being taxed at all is dependent solely on the facts of the individual case." *Container*, 463 U.S. at 188. Given that fact and the existence in this case of the other two distinguishing factors, distinguishing *Container* from *Japan Line*, it cannot be concluded that New Mexico's tax violates the Foreign Commerce Clause of the United States Constitution based upon the possibility of double taxation.

The second ground upon which a state tax may be prohibited under the operation of the Foreign Commerce Clause is where a state tax "may impair federal uniformity in an area where federal uniformity is essential; *Japan Line*, 441 U.S. at 448; and where the tax "prevents the federal government from speaking with one voice in international trade." *Id.* at 453. In *Japan Line*, the Court found that the California tax impaired federal uniformity in an area where federal uniformity was essential based upon the fact that both the United States and Japan had signed a customs convention on containers, providing that containers temporarily imported are free of all duties and taxes whatsoever. Thus, the convention reflected a uniform federal policy with regard to the foreign instrumentality sought to be taxed. There has been no evidence presented that New Mexico's tax on NCR's foreign source income contravenes any treaties or any other stated policy of federal uniformity with regard to state taxation of such foreign source income of a domestic corporation. With respect to preventing the federal government from "speaking with one voice on international trade," the best evidence of this is if the state tax violates some clear federal directive. There can be no doubt that if Congress wanted to put an end to this form of state taxation of the income of domestic corporations, Congress could effectively stop

it with its preemptive power to regulate commerce with foreign nations. However, Congress has not seen fit to do so. As noted in both *Mobil* and *Container*, "Congress has long debated but has not enacted legislation designed to regulate state taxation of [such] income." *Mobil*, 445 U.S. at 448. *Container*, 463 U.S. at 196-197. As in *Container*, in this instance, there are no "specific indications" through congressional enactments or federal treaties of federal intent to preempt state taxation of unitary foreign dividends, royalties or interest received by United States domestic corporations from their foreign subsidiaries.

This case is quite different than *Japan Line*, in which a state sought to impose a property tax on the property of a foreign corporation which was used exclusively in foreign commerce. In this case, New Mexico is attempting to tax its apportioned share of the income of a United States corporation which engages in unitary business with New Mexico. New Mexico is not attempting to tax any part of the income of NCR's foreign subsidiaries. It is only when NCR Corporation is actually paid a dividend, royalty or interest by one of its foreign subsidiaries that that income becomes a part of NCR's total income of which New Mexico is seeking to tax an apportioned share.

With regard to the Foreign Commerce Clause arguments raised by NCR, it is also noteworthy that this identical issue has been decided adversely to NCR Corporation by the supreme court of Minnesota. *NCR Corporation v. Comm'r of Revenue*, 438 N.W.2d 86 (MN 1989), *cert. denied*, 110 S. Ct. 144 (1989). *See also, NCR Corporation v. Comptroller of the Treasury*, 544 A.2d 764 (MD 1988).

C. *Apportionment Formula Adjustment*

In addition to its challenge of New Mexico's tax on the basis of the Foreign Commerce Clause, NCR also raised an alternative argument which challenges the fairness of New Mexico's apportionment formula with respect to NCR Corporation's foreign source income, based

upon the Due Process and Commerce Clauses. NCR argues that if New Mexico's tax scheme includes NCR Corporation's foreign source income, then its apportionment formula must take into account the factors which gave rise to the foreign source income, *e.g.*, the foreign subsidiaries' property, payroll and sales. NCR's argument may be broken down into two parts. In its first argument, NCR contends that in order to save New Mexico's apportionment formula from constitutional attack, the relevant UDITPA statutes can and must be read to require inclusion of the entire property, payroll and sales of its dividend, royalty and interest-paying foreign subsidiaries in calculating the denominator of NCR's apportionment factor. NCR contends that failure to include those factors in the denominator would render New Mexico's UDITPA formula unconstitutional. Since statutes are to be construed in such a manner as to not render them unconstitutional, if possible, New Mexico statutes should be read in such a manner as to include NCR's foreign subsidiaries property, payroll and sales in the apportionment denominator.

NCR rests its statutory construction argument upon the language which purports to include in the denominator of the property, payroll and sales factors the property, payroll and sales "everywhere." However, New Mexico statutes do not support the interpretation urged by NCR. The relevant apportionment statutes provide that:

- the denominator of the property factor is the "average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax periods." § 7-4-11;
- the denominator of the payroll factor is the "total compensation paid everywhere during the tax period" by the "taxpayer." § 7-4-14;
- the denominator of the sales factor is the "total sales of the taxpayer everywhere during the tax period." § 7-4-16.

Each of these sections explicitly refers to the property, payroll and sales "of the taxpayer." In this case, it is undisputed that the taxpayer for purposes of the imposition of New Mexico's corporate income tax is NCR Corporation's federal consolidated group, which does not include any of NCR's foreign subsidiaries. Thus, the phrase "total compensation paid everywhere" and the phrase "total sales of the taxpayer everywhere" must be construed with reference to the definition of who the taxpayer is for purposes of the calculation.

NCR has made this identical argument in two other states and has been unsuccessful in both instances. In *NCR Corporation v. Comptroller of the Treasury*, 544 A.2d at 776-778, the court rejected NCR's argument on the basis that: 1) the Maryland legislature's purposes in enacting the corporate income tax was to impose tax on as much of a corporation's net income as is constitutionally permissible; 2) the taxpayer was the federal consolidated group, which excludes foreign subsidiaries; and 3) the starting place for the tax calculation was federal taxable income, which also excludes the income of foreign subsidiaries. Thus, the Maryland Court of Appeals ruled that the Maryland statutes do not require the inclusion of NCR's foreign subsidiaries factors in the calculation of the "everywhere" denominator. The Minnesota Supreme Court arrived at the same conclusion under a similar analysis. *See NCR Corporation v. Comm'r of Revenue*, 438 N.W.2d at 88-91. Both the Maryland and the Minnesota courts declined to follow the reasoning of *Kellogg Company v. Harrington*, 343 N.W.2d 326 (NE 1984). This hearing officer concurs that the reasoning applied by the Minnesota and Maryland courts is far more persuasive than the reasoning of the Nebraska Supreme Court in the *Kellogg* case, and adopts the reasoning of the Minnesota and Maryland courts.

The second part of NCR Corporation's Due Process and Commerce Clause argument posits that inclusion of

NCR's foreign source royalty, interest and dividend income without an adjustment in the apportionment factor denominator to include the total property, payroll and sales figures of NCR's foreign subsidiaries which are responsible for generating NCR's foreign source income is unconstitutional. The United States Supreme Court has not directly spoken to the specific question presented here. In *Mobil*, the Court held that a state could, consistent with the requirements of the Due Process and Commerce Clauses, include dividends paid by unitary foreign subsidiaries in the recipient's apportionable tax base. The Court specifically eschewed, however, any ruling on whether the inclusion of the intercompany payments in apportionable income without adjustments to the apportionment formula was constitutionally permissible because *Mobil* had not raised the issue. *Mobil*, 445 U.S. 425 at 441, n. 15. NCR relies upon Justice Stevens' dissent in *Mobil* which indicates that "unless the sales, payroll and property values connected with the production of income by the dividend payor corporations are added to the denominator of the apportionment formula, inclusion of earnings attributable to those corporations in the apportionment tax base will inevitably cause Mobil's Vermont income to be overstated." *Mobil*, 445 U.S. 425, 461. However, as noted, this statement appears in Justice Stevens' dissent which was not joined by any other justice, nor has Justice Stevens' position been adopted by the Supreme Court in any subsequent cases.

NCR contends that the New Mexico taxation scheme violates the standard of fairness imposed by the Due Process and Commerce Clauses, as set forth in *Container Corporation*, 463 U.S. 159, 169. In *Container*,[2] the Supreme Court set out two standards by which the constitutional fairness of an apportionment formula may be

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[2] In *Container*, the Supreme Court upheld the application of California's corporation franchise tax under the worldwide combined reporting methodology and denied any apportionment formula adjustments.

judged. The first standard is called "internal consistency." This means that the apportionment formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed. The second and more difficult standard, "external consistency," requires that the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how the income to be apportioned is generated. It is the second standard which NCR Corporation contends the New Mexico formula violates.

At first blush, NCR's argument is compelling. It points out that, under New Mexico's hybrid system (as opposed to worldwide combined reporting), the intangible income from subsidiaries is included in the apportionable tax base of the parent corporation, yet no recognition of the subsidiaries' contributions to that income is reflected in the factors used to apportion that income because none of the foreign subsidiaries' property, payroll or sales is included in the factor denominators. NCR exemplifies this problem by contrasting its branch income to its subsidiary income. Some of NCR's foreign business is conducted through branches and some is conducted through subsidiary corporations. Under New Mexico's hybrid system, NCR branches are part of the federal consolidated reporting group upon which federal corporate income is reported. Thus NCR branch income, as well as the property, payroll and sales of NCR branches, are included in New Mexico's NCR apportionment formula. However, when NCR operates through foreign subsidiaries, although NCR's income from its foreign subsidiaries is included in federal taxable income, and therefore New Mexico apportionable income, the property, payroll and sales of the foreign subsidiaries are excluded from New Mexico's apportionment factors. NCR also attempts to show how inclusion of the foreign source interest, royalties and dividends distorts NCR's apportionable income through Tables 1 and 2 of its post-hearing brief, pages 37 and 38. These tables compare NCR's foreign source income to NCR's

totally domestic income, showing that NCR's foreign source income actually exceeded its domestic income in some of the years in question, and was, in fact, a significant portion of NCR's total apportionable income in all relevant years.

These issues warrant much closer examination, however. Although foreign source income is included in the apportionable tax base without the factors of the foreign unitary businesses being taken into account by New Mexico's apportionment formula, it is noteworthy to point out that inclusion of foreign source royalty, dividend and interest income by no means constitutes an all-inclusive inclusion of all foreign source income. It reflects only inclusion of foreign source income actually paid to the NCR parent corporation. Thus, the differential tax treatment resulting between the distinction in the form in which business is conducted, *e.g.*, branches v. subsidiaries, has a factual basis. With branch income, all income and all factors are included in the apportionment formula. With subsidiaries, not all income has been included in the income pie to be apportioned, and thus, there is at least some basis for not including the entire property, payroll and sales in the denominator of the apportionment factor. Furthermore, there is, in fact, no direct correlation between the foreign source income of NCR Corporation and the amount and extent of its subsidiary income. Interest and royalties are paid regardless of whether the subsidiary earns income or not, as a result of licensing agreements and loans between parent and subsidiary. Findings of Fact Nos. 12 and 13.

The United States Supreme Court has long recognized the complexity of fairly apportioning multijurisdictional income. As it stated in *Container Corp.*, 463 U.S. at 192, "Allocating income among various taxing jurisdictions bears some resemblance, as we have emphasized throughout this opinion, to slicing a shadow. In the absence of a central coordinating authority, absolute consistency even among taxing authorities whose basic ap-

proach to the task is quite similar, may just be too much to ask." It is precisely because of these complexities that the Supreme Court has refused to dictate to states the application of any particular apportionment formula. *Id.* at 164. Rather, a taxpayer attempting to challenge its particular apportionment formula has the burden of proving " 'by clear and cogent evidence' that the income attributed to the state is in fact 'out of all appropriate proportions to the business transacted in that state,' [*Hans Rees' Sons, Inc.*] 283 U.S. at 135, or has 'led to a grossly distorted result,' [*Norfolk & Western R. v. State Tax Commission*, 390 U.S. 317, 326]. *Moorman Mfg. Co., supra*, 437 U.S. at 274. *Container*, 463 U.S. at 170 and 180-181. The question thus presented is whether the apportioned share of NCR's income being taxed by New Mexico is "out of all appropriate proportion" or leads to "a grossly distorted result."

We have little guidance from the courts on how to measure "appropriate proportion" or "gross distortion." We do know, however, that the Supreme Court has invalidated an apportionment formula that resulted in more than 250% difference between the taxpayer's reasonable alternative formula and the state's formula. *Hans Rees' Sons, Inc. v. North Carolina, ex rel. Maxwell*, 283 U.S. 123. It is rather easy to see how a 250% difference could be considered a "gross distortion." We also have guidance that the Supreme Court did not find a 14% difference to be out of all appropriate proportion or grossly distorted. In *Container*, the Court found that such a difference was "clearly within the margin of error inherent in any method of attributing income among the components of unitary business." *Container*, 463 U.S. at 184. A careful review of the facts in this case must be engaged in to determine the amount or degree of disproportionality or distortion resulting from the application of New Mexico's apportionment formula. Before engaging in this endeavor, it must be noted that the figures used for comparison purposes for NCR Corporation, compar-

ing its U.S. v. foreign source income, is not an appropriate measure to determine the reasonableness of New Mexico's apportionment formula. In fact, the apportionment formula has not even been applied to the figures set forth in the tables in NCR's post-memorandum brief. In *Container*, the United States Supreme Court looked at the "percentage increase in taxable income" caused by the application of the challenged statutory apportionment method as opposed to an adjusted formula for apportionment. *Container*, 463 U.S. at 184. Likewise, in the case in which NCR successfully argued for an apportionment factor adjustment, *NCR Corporation v. Comptroller of the Treasury*, 544 A.2d 764, the Maryland Court of Appeals stated that "the proper focus of the inquiry for the purposes of determining apportionment distortion is on the percentage increase in taxable income apportioned to the taxing state. [sic] *Id.*, 544 A.2d at 780.

The next issue to be determined, then, is the apportionment formula to be used for comparison to the state's apportionment formula. In the *NCR Maryland* case, the Maryland Court of Appeals agreed that some factor adjustment may be warranted, but it lacked sufficient information to determine the proper methodology and remanded the case to the tax court for those calculations. With respect to the apportionment formula to be used, the court noted,

> Nonetheless, it may not be unreasonable to suggest that inclusion of subsidiaries' dividends in the apportionable income should be balanced by some changes in the formula denominator. *But the balancing should not be done by including the total property, sales and payroll values of the subsidiaries in the formula denominators.* Instead, the denominator should be modified by including only those percentages of the foreign subsidiaries' property, payroll and sales that generated the foreign subsidiary dividend income tax by Maryland.

Id. at 781 (emphasis added). Thus, the Maryland court realized that in coming up with a reasonable alternative apportionment formula, since there is no direct correlation between actual subsidiaries' income and the foreign source income paid to NCR parent corporation, the apportionment formula should take into account only the appropriate proportion of the total property, sales and payroll of the foreign subsidiary. In this case, a comparison of the amount of the total royalty, interest and dividends paid to NCR from Finding of Fact 29 with the subsidiaries' gross income by year, Finding of Fact 40, demonstrates that the subsidiaries paid NCR only a fraction of their earnings each year, thus warranting a similar approach. This comparison is contained in Table 1 of the Department's answer brief, page 16. The use of the foreign subsidiaries' gross rather than net revenues for purposes of comparison is appropriate for two reasons. First, the foreign source dividend, royalty or interest payments are made out of gross revenues because, as has been pointed out, these payments are made even if NCR may have incurred a loss. Additionally, the factors used in the apportionment formula itself for property, payroll and sales are gross figures.

In its answer brief, the Department has provided the calculations showing the difference in NCR's apportionable income using the New Mexico statutory formula and the amount calculated by applying a fractional reduction to the apportionment factors corresponding to the fraction created by comparing NCR's foreign source income to the gross revenues of the foreign subsidiaries. This was set out as Table 3 and is set forth in its entirety below.

TABLE III

	N.M. Taxable Income Per Statute	Factor Adjustment	Adjusted Factors	Adjusted N.M. Taxable Income	Difference Between Statutory & Adjusted N.M. Taxable Income
1981	$ 480,939	.065840	.3010%	$ 460,881	$ 20,058 (4%)
1982	$ 743,607	.076038	.3080%	$ 661,164	$ 82,443 (12%)
1983	$ 917,360	.076749	.3172%	$ 879,912	$ 37,448 (4%)
1984	$ 939,487	.085802	.2839%	$ 899,563	$ 39,924 (4%)
1985	$ 945,831	.086000	.2699%	$ 905,244	$ 40,587 (4%)
1986	$ 446,116	.080171	.2877%	$ 424,570	$ 21,546 (5%)
1987	$1,080,427	.142424	.2020%	$ 988,882	$ 91,545 (9%)
TOTAL:	$5,553,767			$5,220,216	$333,551 (6%)

As can be seen from this table, the difference between the income apportioned to New Mexico under the statutory formula and that apportioned to New Mexico under the adjusted formula ranges between 4 percent and 12 percent on an annualized basis, with an average differential of 6 percent for all of the years in question. This hardly rises to the level of a "grossly distorted result" which is "out of all appropriate proportion" to the business transacted in New Mexico by NCR, if we are to use the *Container* case as a guide. As noted previously, the Supreme Court in the *Container* case did not find a 14 percent distortion to be constitutionally impermissible. It thus appears the New Mexico statutory apportionment formula does a reasonable job of "slicing the shadow," and falls "clearly within the margin of error inherent in any method of attributing income among the components of [a] unitary business." *Container*, 463 U.S. at 192 and 184.

As noted above, the courts of Maryland did grant NCR Corporation some factor relief consideration (the amount in extent of which does not appear of record because the matter was remanded to a lower court for such determination). Thus, it appears that the Maryland court assumed that there was distortion of constitutional significance even though it did not have any information as to the percentage increase in taxable income apportioned to the state under the state's formula. Since the *Container* decision relied upon such calculations *before* determining whether a distortion of constitutional significance existed, the Maryland decision is not considered persuasive as to whether apportionment formula adjustment is warranted in this case. More persuasive is the reasoning of the Minnesota Supreme Court. In *NCR Corporation v. Comm'r of Revenue*, 438 N.W.2d 86 (1989), Minnesota Supreme Court examined and addressed the same claims that NCR makes in this case. It concluded that, "[T]hus we hold that NCR has failed to demonstrate by clear and cogent evidence that the relatively small re-

sulting disparity in tax fails to properly reflect how the income was generated or, that an excessive amount of that income was attributed to Minnesota under proper application of its apportionment statute to be constitutionally impermissible." *Id.* at 93. In that case, the amount of increase in the corporate taxes amounted to 23%, far larger than exists in this case. It cannot be concluded that an overall six percent differential from the application of New Mexico's apportionment formula as compared to another reasonable apportionment formula rises to the level of a constitutionally impermissible unfairness. Accordingly, neither the Commerce Clause nor the Due Process Clause requires the apportionment formula adjustments NCR requests in this case.

D. *Subpart F Income*

The next issue involves whether New Mexico may include in NCR Corporation's apportioned tax base any portion of what is called NCR Corporation's Subpart F income. New Mexico calculates its corporate income tax beginning with federal taxable income. *See,* Section 7-2A-2(C) NMSA 1978. The Internal Revenue Code, 26 U.S.C. Section 951, includes Subpart F income in the gross income of certain United States taxpayers, of which NCR Corporation is one. There is no dispute that New Mexico's statutory scheme requires the inclusion of NCR Corporation's Subpart F income in NCR's apportionable tax base for New Mexico corporate income tax purposes. NCR Corporation contends, however, that for constitutional reasons, the Subpart F income must be removed from consideration. A description of Subpart F income and the background surrounding its federal tax treatment will provide a context for the discussion of NCR's argument.

The Subpart F provisions are set out in the Internal Revenue Code, I.R.C. Section 951 through 964. Subpart F requires that United States shareholders of "controlled foreign corporations" (CFCs) to [sic] report as

income their pro rata share of the CFCs' "Subpart F income," which in this case amounted to undistributed earnings of NCR's foreign subsidiary corporations, and the foreign subsidiary corporations' increase in earnings invested in United States property. I.R.C. § 951(a).

The Subpart F provisions of the Internal Revenue Code are an exception to the general principle that shareholders are not taxable on the undistributed earnings of their corporations. The Subpart F provisions were enacted in 1962 to prevent U.S. corporations from avoiding income tax by investment in foreign subsidiaries based in tax haven countries, that is, countries with lower tax rates than the United States and with bank secrecy and corporate nondisclosure laws. *See, generally, 19th Annual Institute on International Taxation: Subpart F, Practicing Law Institute Handbook Series,* William L. Bricker, Jr., 1989; "U.S. Countermeasures Against Tax Haven Countries," 26 Columbia J Transnat'l Law 553 (1988). It was recognized that U.S. parent corporations were avoiding billions of dollars in federal tax by operating abroad through controlled foreign subsidiaries. *Id.* U.S. corporations had control of the revenues of the foreign companies and could move these funds all over the world among a network of foreign subsidiaries or even invest it in U.S. property without ever having the income subjected to U.S. taxation. *Id.* To combat this problem, Subpart F was enacted, in substance treating shareholders of controlled foreign corporations as if they had received actual dividend distributions from their CFCs, recognizing some of the subsidiary income to be income to the parent, even though no income was actually distributed.

During the tax years at issue, NCR Corporation had approximately $320 million in Subpart F income. Of this amount, approximately $180 million represents the proceeds of a loan from NCR Japan to NCR Corporation. NCR Japan was a controlled foreign corporation of NCR which had substantial undistributed earnings which the laws of Japan prohibited NCR Japan from distributing.

In order to obtain use of this money, NCR Corporation obtained a loan of $180 million from NCR Japan. The transaction is a bona fide loan, however, and NCR Corporation is repaying NCR Japan both principal and interest. The remaining portion of NCR Corporation's Subpart F income during the tax years at issue represents other undistributed income from other NCR foreign subsidiaries.

NCR raises three arguments with respect to the treatment of its Subpart F income. First, it contends that Subpart F income is hypothetical income, akin to Internal Revenue Code Section 78 "gross-up," which New Mexico does not tax. NCR contends that Subpart F income should be treated identically. The second argument raised is that New Mexico's inclusion of Subpart F income is barred by the operation of the Due Process Clause of the United States Constitution. Finally, NCR contends that a portion of its Subpart F income has already been taxed and that New Mexico is thus precluded by the Equal Protection Clause, the Commerce Clause and Article VIII, Section 1 of the New Mexico Constitution, from taxing this income a second time. These issues will be addressed in reverse order.

With respect to the third issue, the double taxation arises from the fact that during tax years 1978 through 1980, NCR contends that NCR Japan earned some of the income that was later loaned to NCR Corporation. During those years, NCR Japan and NCR Corporation filed their tax returns in New Mexico on a worldwide combined basis. Under worldwide combined reporting, the income of all the members of the combined group was included in NCR's apportionable tax base. Thus, NCR contends that some portion of its Subpart F income during the years in protest was previously taxed by New Mexico in tax years 1978 through 1980. In its answer brief, page 23, the Department concedes that this income previously taxed will be deducted from NCR's Subpart F income. However, as of the date of this decision, NCR

and the Department have not completed their calculations to determine which portion of NCR's Subpart F income must be excluded on this basis. For this reason, NCR's protest is granted as to this as yet undetermined portion of the Subpart F income. Upon conclusion of any appeal of this issue, if such appeal does not render this issue moot, and if at that time the parties are unable to agree to the amount of Subpart F income attributable to this issue, the record shall be reopened for the taking of evidence on this issue.

Next, NCR contends that the Due Process Clause of the U.S. Constitution prohibits this state from including NCR's Subpart F income in the New Mexico apportionable tax base because the income does not derive from sources within this state. NCR's argument goes like this. Although it is conceded that the federal government possesses the power, under the 16th Amendment, to tax NCR Corporation on its undistributed income earned from its investment in foreign corporations, that power is based upon the power of Congress to tax U.S. residents on their income from all sources. However, it argues that Congress's power would be circumscribed insofar as it would attempt to tax income of nonresident individual or foreign corporations, except insofar as that income derives from sources within the United States. NCR asserts that states are similarly circumscribed and are prohibited from taxing nondomiciliary foreign corporations, except on income derived from sources within the state, citing *Shaffer v. Carter,* 252 U.S. 37, 52 (1920) and P. Hartman, *Federal Limitations on State and Local Taxation,* ¶ 9:7 at 472 (1981). NCR argues that since it is a foreign corporation domiciled outside of New Mexico, New Mexico is thus circumscribed in its ability to tax NCR, and may only do so as to its income derived from sources within New Mexico. NCR argues that the undistributed income of NCR's wholly-owned foreign subsidiaries cannot possibly have its source within New Mexico, and therefore due process precludes New Mexico's tax.

This argument amounts to little more than the arguments concerning the sourcing of income presented to the U.S. Supreme Court over the many years in which the unitary business concept was evolved. As stated by the U.S. Supreme Court in *Mobil,* 445 U.S. at 439,

> The argument that the source of the income precludes its taxability runs contrary to precedent. In the past, apportionability has often been challenged by the contention that income earned in one state may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and extrastate activities form part of a single unitary business. [Citations omitted.]

The Court goes on to state that,

> As these cases indicate, the linchpin of apportionability in the field of state income taxation is the unitary business principle. In accord with this principle what appellant must show, in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that the income was earned in the course of activities unrelated to the sale of petroleum products in that state.

Id. at 440. In this case, it was stipulated that there is a substantial flow of goods between NCR Corporation and its domestic and foreign subsidiaries and branches and that the business conducted by NCR Corporation throughout the world, both directly and through its domestic and foreign subsidiaries is a single, integrated unitary business. Finding of Fact No. 8. NCR Corporation conducts part of its unitary business in New Mexico, therefore New Mexico has nexus to impose its tax on an apportioned share of NCR's unitary income. New Mexico, in including NCR's Subpart F income in its total apportionable income, is not taxing value generated outside its borders. Rather, it is taxing the income which the federal govern-

ment has determined to be enjoyed by the U.S. parent of a unitary business. So long as the subsidiaries with Subpart F income are part of NCR's unitary business and the federal government requires inclusion of this Subpart F income in NCR's gross income, New Mexico, under the unitary business principle, may apportion and tax its share of that income without contravening due process.

The final argument which NCR makes with respect to its Subpart F income is that this income, as hypothetical income, may be likened to Internal Revenue Code Section 78 "gross-up" income, which New Mexico has declined to tax since the U.S. Supreme Court decision in *F.W. Woolworth Co. v. Taxation and Revenue Department,* 458 U.S. 354 (1982). For discussion purposes, it can be assumed that Section 78 gross-up is hypothetical income in the same manner that Subpart F income is. In both cases, the income is deemed income for federal taxation purposes, even though actual income may not have been paid. The Department agrees that it does not presently include Section 78 gross-up in the New Mexico apportionable tax base, but it does not concede that it is legally required to grant such treatment by any legal or constitutional restraints.

An examination of the *Woolworth* litigation does not reveal any "per se" bar to state taxation of such hypothetical or deemed income. In the *Woolworth* litigation, the Department contended that F.W. Woolworth's Section 78 gross-up income was income for New Mexico apportionment purposes because it was included in the definition of federal taxable income. The court of appeals ruled that the gross-up was not, in fact, actual dividend income to the taxpayer and, therefore, it cannot be classified as business income subject to apportionment in New Mexico. *F.W. Woolworth Co. v. Bureau of Revenue of New Mexico,* 95 N.M. 542, 544, 624 P.2d 51 (Ct. App. 1979). On appeal, the New Mexico Supreme Court reversed the court of appeals, stating that the issue was not whether or not the income was business income. Rather,

the court held that the issue turned on the consideration of the state taxing scheme, which bases New Mexico taxable income on federal income. It ruled that the New Mexico statutory scheme was constitutional, unambiguous and not subject to statutory construction or judicial legislation by the lower court. *Taxation and Revenue Department v. F.W. Woolworth Co.*, 95 N.M. 519 at 521-524, 624 P.2d 28 (1981). Although the United States Supreme Court reversed the New Mexico Supreme Court in *F.W. Woolworth Co. v. Bureau of Revenue*, 485 U.S. 354 (1982), the New Mexico Supreme Court's decision was reversed on grounds other than those surrounding the Section 78 gross-up issue. The Supreme Court ruled that it did not "need . . . [to] be detained" concerning the Section 78 gross-up issue because it had already decided that New Mexico could not tax any dividends, whether they were real or deemed dividends, from F.W. Woolworth's subsidiaries because New Mexico had failed to prove that the requisite unitariness existed between Woolworth and its subsidiaries. Thus, no constitutional basis existed for New Mexico to claim any share of any sort of dividend income from F.W. Woolworth's nonunitary subsidiaries. The two state courts which have examined and applied this aspect of *Woolworth* concur with this interpretation of the *Woolworth* litigation with respect to Section 78 foreign dividend gross-up. *See, NCR Corporation v. Comptroller of the Treasury*, 544 A.2d 764, 768-769 (MD 1988), *International Minerals and Chemical Corp. v. Heitkamp*, 417 N.W.2d 791, 795-796 (ND 1987). Thus, the hypothetical nature of the Subpart F income does not preclude New Mexico from including this income in NCR Corporation's total income subject to apportionment in New Mexico. As long as it is treated as income for federal purposes, a state may include it in income for state purposes as well. *NCR v. Comptroller, supra, International Minerals, supra. See also, Dow Chemical Company v. Director of Revenue*, 787 S.W.2d 276, 284-286 (MO 1990) (*en banc*).

E. *Conclusion.*

For all of the foregoing reasons, IT IS DECIDED AND ORDERED that NCR's protest insofar as it involves a protest to the inclusion of a portion of its Subpart F income which was previously taxed in New Mexico is hereby granted. All other portions of NCR's protest are hereby denied.

Done this 18th day of March, 1991, in Santa Fe, New Mexico.

/s/ Gerald B. Richardson
GERALD B. RICHARDSON
Taxation and Revenue Department

/s/ Dick Minzner
DICK MINZNER
Secretary
Taxation and Revenue Department

APPENDIX C

IN THE SUPREME COURT
OF THE STATE OF NEW MEXICO

July 8, 1993

No. 21,302

NCR CORPORATION,
Petitioner,

vs.

TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO,
Respondent.

This matter coming on for consideration by the Court upon petition for writ of certiorari, and the Court having considered the petition being sufficiently advised;

NOW, THEREFORE, IT IS ORDERED that petition for writ of certiorari hereby IS DENIED.

IT IS FURTHER ORDERED that the record in cause numbered 13,035 hereby is returned to the New Mexico Court of Appeals.

APPENDIX D

NEW MEXICO STATUTES INVOLVED*

7-2A-1. Short title.

Chapter 7, Article 2A NMSA 1978 may be cited as the "Corporate Income and Franchise Tax Act".

7-2A-2. Definitions.

For the purpose of the Corporate Income and Franchise Tax Act [this article] and unless the context requires otherwise:

* * * *

C. "base income" means that part of the taxpayer's income defined as taxable income and upon which the federal income tax is calculated in the Internal Revenue Code for income tax purposes plus, for taxable years beginning on or after January 1, 1991, the amount of the net operating loss deduction allowed by Section 172(a) of the Internal Revenue Code, as that section may be amended or renumbered, and claimed by the taxpayer for that year; "base income" also includes interest received on a state or local bond;

* * * *

I. "net income" means base income adjusted to exclude:

(1) amounts that have been taxed as income under the Banking and Financial Corporations Tax Act;

(2) income from obligations of the United States less expenses incurred to earn that income;

(3) other amounts that the state is prohibited from taxing because of the laws or constitution of this state or the United States;

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* The statutes in effect for the years at issue (1981-87), which were amended over the years in minor respects having no bearing on the controversy before this Court, are substantially similar to the current statutes, reproduced herein.

(4) for taxable years that began prior to January 1, 1991, an amount equal to the sum of:

(a) net operating loss carryback deductions to that year from taxable years beginning prior to January 1, 1991 claimed and allowed, as provided by the Internal Revenue Code; and

(b) net operating loss carryover deductions to that year claimed and allowed; and

(5) for taxable years beginning on or after January 1, 1991, . . .

7-2A-3. Imposition and levy of taxes.

A. A tax to be known as the "corporate income tax" is imposed at the rate specified in the Corporate Income and Franchise Tax Act [this article] upon the net income of every domestic corporation and upon the net income of every foreign corporation employed or engaged in the transaction of business in, into or from this state or deriving any income from any property or employment within this state.

B. A tax to be known as the "corporate franchise tax" is imposed in the amount specified in the Corporate Income and Franchise Tax Act upon every domestic corporation and upon every foreign corporation employed or engaged in the transaction of business in, into or from this state or deriving any income from any property or employment within this state and upon every domestic or foreign corporation, whether engaged in active business or not, but having or exercising its corporate franchise in this state.

7-2A-4. Consolidated returns.

A. Any corporation that is subject to taxation under the Corporate Income and Franchise Tax Act [this article] and that reports to the internal revenue service for federal income tax purposes its net income consolidated

with the net income of one or more other corporations may elect to report to New Mexico on the same basis.

B. Once a corporation has been included in a consolidated return to New Mexico, the corporation shall not elect to file a New Mexico return under any other method without prior permission of the secretary, unless the change in reporting method is required or allowed under the Internal Revenue Code. Furthermore, such a corporation shall not elect nor shall the secretary grant it permission to separately account for income in New Mexico pursuant to Paragraph (4) of Subsection A of Section 7-2A-8 NMSA 1978.

7-4-1. Short title.

Chapter 7, Article 4 NMSA 1978 may be cited as the "Uniform Division of Income for Tax Purposes Act".

7-4-10. Apportionment of business income.

All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

7-4-11. Property factor for apportionment of business income.

The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

7-4-14. Payroll factor for apportionment of business income.

The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period

by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the tax period.

7-4-16. Sales factor for apportionment of business income.

The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.